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**FINANCING SPECIAL EDUCATION:
ANALYSES AND CHALLENGES**

MARCH 2012

REPORT 378

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FINANCING SPECIAL EDUCATION: ANALYSES AND CHALLENGES

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Summary

In the early 1970's Michigan was a leader among the states when it passed a seminal law to guarantee that disabled students receive special education services. Forty years later, after Michigan's pioneering efforts, both federal and state laws across the country mandate that all eligible students receive a free appropriate public education in the least restrictive environment. In Michigan, these federal and state mandates can have serious financial implications for both state government and the school districts responsible for providing nearly 225,000 disabled students each year with services and programs tailored to their individual educational needs.

The report collects and synthesizes data from various

sources, including the Michigan Department of Education, Michigan Department of Treasury, and individual intermediate school districts (ISD) to develop a comprehensive picture of special education finances – something that does not exist in a single source because of the structure of the finance system. The picture reveals fairly significant differences among school districts in a number of key areas; per-pupil revenues/spending, reliance on local property taxes, and the concentration of special education students in districts. After looking at the historical financial data, the report examines the challenges, prospectively, associated with financing special education and how these challenges spill over to affect general K-12 finances.

Key Findings

Key findings from the report include:

- About 225,000 students in Michigan received special education services in 2010, representing nearly 14 percent of the total K-12 population. This was about the same number of students that received services in 2000, but fewer than the number of students in 2005, when almost 251,000 students received special education services. For the most part, annual changes in the special education population have tracked the general student enrollment trends since the mid-2000s. The dispersion of disabled students varied among individual school districts and among types of public schools.

In 2010, the percentage of special education students among traditional local public school districts ranged from 4 percent (Nottawa Community School) to 29 percent (Redford Union School District). Even districts of similar overall size and demographic composition had very differently sized special education populations. For example, 13 percent of the students at South Redford School District in Wayne County received special education compared to 29 percent of the students at nearby Redford Union School District.

Compared to 2000, the percentage of disabled students in the traditional public school environment in 2010 was relatively unchanged at 13 percent. Over the same ten-

year period, the percentage of disabled students in charter schools statewide increased from 5.4 percent in 2000 to 9.7 percent in 2010. While the number of students enrolled in charters nearly doubled during this period, the number of charter students in special education nearly tripled.

- For a ten-year period ending in Fiscal Year 2010 (FY2010), statewide total special education spending increased at an average annual rate of 4.8 percent per year, double the average annual increase in inflation over the period.

In FY2010 (most recent data), school districts reported \$3.4 billion in combined special education expenditures, up 60 percent from the amount in FY2000. Significant annual spending increases from 2000 to 2006 (between 6 and 8 percent annually) accompanied the growing special education population. As special education annual enrollment growth tapered off and began to decline in 2006, spending growth moderated (around 3 percent per year). Over the last decade, total spending increased at a 4.8 percent annualized rate or twice as fast as the change in inflation (2.4 percent per year).

- Adjusted for inflation, per-pupil special education spending increased from \$12,327 in FY2000 to \$14,397 in FY2010, or 17 percent. In comparison, total K-12 per-pupil spending, adjusted for inflation,

increased 1.4 percent over the same period (from \$9,503 per pupil in FY2000 to \$9,633 per pupil in FY2010).

Over the last ten years, special education spending grew faster than overall K-12 spending, both in the aggregate and on a per-pupil basis. Further, this spending exceeded changes in inflation. A key factor in this growth was the steady increase in enrollment. Another likely factor that contributed to this growth was the higher costs associated with delivering special education services and running related programs. These costs are driven by smaller class sizes, the need for special education aides in the classroom, the rising number of specialists, and the costs of diagnostic and professional support services (nursing and various therapies).

- Per-pupil spending varies significantly among intermediate school districts and the disparities have grown in recent years. This contrasts with the per-pupil spending differences for general K-12 education where the gap between the highest and lowest spending districts has eroded over the years.

In 2010, per-pupil special education spending (excluding transportation) averaged just over \$13,800 statewide. However, amounts among ISDs ranged from \$8,832 per pupil (Delta-Schoolcraft ISD) to \$18,932 per pupil (Washtenaw ISD). The highest per-pupil amount was more than twice the lowest amount.

Over the last four years, the disparities in funding at the extremes have grown. In 2007, per-pupil spending ranged from \$7,798 (Iosco ISD) to \$15,572 (Oakland Schools), a difference of \$7,774. Between 2007 and 2010, the range (difference between highest and lowest) increased to \$10,100. The widening gap between the highest and lowest is further evidenced in the fact that the ratio of the two extremes increased from just below 2.0 in 2007 to nearly 2.2 in 2010.

- Since the Supreme Court's landmark *Durant* decision in 1997, the State of Michigan's responsibility for funding special education has been a fixed percentage of eligible costs. Therefore, state special education costs change with total costs, regardless of the condition of the state budget or the needs of other state programs. As total special education costs rose faster than inflation since *Durant*, so has the amount of state special education funding.

State reimbursement increased steadily from \$568 million in FY1998 to \$923 million in FY2009, before exhibiting its first decline in FY2010 (\$879 million). From FY1998 to FY2010, total state costs were up 55 percent com-

pared to a 34 percent increase in inflation. State government's responsibility for special education is fixed as a result of *Durant*; therefore, when the state budget faces challenges, special education funding is largely protected from cuts.

The decrease in School Aid Fund purchasing power since FY2000, combined with the inflation-adjusted growth of special education costs over the same period, meant that proportionately more School Aid Fund dollars had to go towards satisfying the *Durant* mandate. This has left fewer resources for other K-12 education services, namely the per-pupil foundation grant. *Durant* obligations, as a percent of total School Aid Fund revenue, grew steadily from 6.2 percent in FY1998 to 8.4 percent in FY2009, before falling to 8.1 percent in FY2010.

- Intermediate school districts are expected to seek voter approval for millage rate increases to the special education property tax to make up for the tax base erosion that has occurred with the housing market decline and the Great Recession.

For most districts, the ISD special education property tax is the primary funding source for services and programs. This tax, like all other local property taxes, faces both constitutional and statutory limitations on the growth of the tax base. Also, there are hard caps on the maximum rate allowed (1.75 times 1993 rate). A total of 49 ISDs experienced a reduction in their total tax yield in 2011. Because of enrollment declines in many districts, only 27 districts had reductions in their per-pupil tax yield.

- Michigan's special education funding system is structured in such a way that general fund budgets (primarily those of local constituent districts, but also ISDs) serve as the "fund-ers of last resort" when it comes to financing special education services. When the costs of mandated programs and services exceed the amount of dedicated special education revenues from all sources combined (federal, state, and local), districts' general fund dollars must make up the difference. In recent years, the amount of the subsidy has declined, but going forward general funds may be asked to play a larger role with declines in property tax revenues.

For the entire state, the general fund subsidy amounted to 19 percent, or \$655 million, of total costs in FY2010. This was the smallest piece of the total funding pie; just below the amount of federal funding (22 percent of total). From a historical perspective, the size of the general fund subsidy in FY2010 is somewhat misleading because of the infusion of federal stimulus funds. Prior to

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the availability of these one-time resources, the federal share was smaller and other components' shares (including general funds) were larger. In FY2007, the general fund subsidy accounted for 25 percent of all reported costs, the third largest piece and larger than the amount of on-going federal dollars (15 percent of the total). Comparing FY2007 to FY2010 suggests that local and intermediate school districts were able to reduce, at least temporarily, the amount of general fund support they supplied for special education because of the availability of sizeable amounts of federal stimulus resources.

- Special education finances benefited from substantial one-time federal stimulus funding during FY 2010 and FY2011. While these resources provided schools

with short-term relief, the long-term challenges remain and will re-appear in full beginning in FY2012.

The federal stimulus legislation passed in early 2009 provided temporary general fund budget relief and, in effect, relieved some of the financing challenges facing special education. The amount of direct federal funding in FY2010 more than doubled, from \$355 million to \$755 million as a result of the stimulus. The federal resources helped reduce the amount of general fund resources going to finance special education in FY2010 (\$655 million) compared to FY2007 (\$791 million). The loss of these resources in FY2012 will place pressure on ongoing state and local revenue sources and require budget adjustments.

Outline of Report

The remainder of this report begins with background information about the complex web of state and federal laws governing special education and the related finances. It provides a snapshot of the current special education population, including demographic and socio-economic descriptions. The early discussion also covers enrollment characteristics by type of public school and enrollment changes over time. The next section of the report discusses detailed information regarding finances, both spending and revenue issues. The report looks at components of spending as well as the different sources of revenue (both level of government and type of tax) used to finance the spending. It examines financial information at the statewide level as well as the individual district level, and when appropriate, presents comparisons

across school districts.

The report concludes by identifying the primary challenges facing special education: both new and old. These challenges include federal and state policies mandating certain services. It also reveals that the financing structures used by state government and local districts pose their own set of challenges. In some cases, state and federal policies create spending pressures on state and local school district special education budget. In other instances, revenue pressures arise from the structure of the taxes designed to support special education. Addressing these challenges will require policymakers to pay attention to both sides of the special education budget, revenues and spending.

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Introduction

Michigan has been at the forefront of states' efforts to ensure that the educational needs of students with disabilities are met. Before the adoption of federal law on the matter in the mid-1970s, Michigan passed a seminal law guaranteeing that disabled students receive special education services. Forty years later, after Michigan's pioneering efforts, both federal and state laws mandate that all eligible students receive a free appropriate public education. These mandates can have serious financial implications for both state government and the local school districts responsible for providing nearly 225,000 disabled students each year with services and programs tailored to their individual educational needs.

This report examines the complex structure of Michigan's special education finance system and how it interacts with general K-12 education finances. The report highlights how much is spent on services and programs to disabled students and how these expenditures are financed. Where appropriate, comparisons are made with spending in the general K-12 education setting. Current financial information is examined as well as historical figures and the changes that occurred over time. The report looks at the major federal, state, and local revenue sources, and the unique challenges, both historically and prospectively, faced by each major source. Where possible, differences at the intermediate school district level (ISD) (i.e., local constituent districts' financial information is aggregated to the ISD level) are analyzed to show

how the financing challenges are affecting districts differently across the state.

Local governments of all levels have found their budgets under considerable strain because the economic conditions in Michigan and K-12 education providers are no different. At the same time that K-12 education finances face pressures on the revenue-side of the ledger because of Michigan's economic struggles, they are experiencing spending pressures, including those associated with the mandates to fund special education. For this reason, this report pays particular attention to the responsibility placed on local and intermediate school districts' general fund budgets to fund special education. It looks at how this responsibility has changed with the downturn in the economy and the housing market, as well as other developments. In a similar vein, state government has a fixed responsibility for funding special education costs as a result of the Michigan Supreme Court's landmark *Durant* ruling in 1997. The state's financial responsibility has to be met regardless of the fiscal condition of the state budget and often times to the detriment of other budget priorities. As proportionately more scarce state resources are directed to special education, fewer dollars are available for other K-12 education programs. This report also looks at how discretionary budgets at both the state and local level are affected by the special education mandates.

Background

A complex mix of federal and state laws dictates special education services and its related finances. Many, if not all, of the programs and services provided to disabled students are defined by these laws, some of which are accompanied by funding and many that do not supply additional resources. Multiple actors (state and federal government, local school districts (traditional public and charter schools), and intermediate school districts), with a range of responsibilities, are involved in this endeavor. The complexity found in special education governance is reflected in the variety of funding sources and financing structures used. A clear understanding of the relevant laws, rules, and regulations that influence special education governance is a prerequisite to making sense of special education finances. In order to provide a backdrop for the discussion of special education finances that appears later in this report, the following background material covers some of the major federal and state laws and provides a profile of Michigan's special education population.

Provisions in Federal Law

A web of federal laws influences special education in the United States. Primarily, these laws touch upon the issue in two important ways. First, certain federal laws contain anti-discrimination provisions designed to protect the rights of individuals with disabilities who participate in programs and activities financed with federal funds, such as education. These laws do not provide funding for compliance with federal mandates. Second, special education is addressed through federal laws that provide funding for services delivered by states and their constituent school districts. These laws can be classified as grant statutes. Both types of laws, individually and synergistically, have shaped today's special education system and how we pay for it.

Nearly 40 years ago, in 1973, the U.S. Congress passed Section 504 of the Rehabilitation Act, a civil rights law. Section 504 prohibits recipients of federal funds from discriminating on the basis of disability. Section 504 codified in federal law the precept that children with disabilities should be provided a free education in public schools.

Prior to this landmark legislation, many children with disabilities were accommodated in state institutions and provided with very basic services such as food, clothing, and housing. Section 504 was borne out of prior precedent-setting court decisions that advanced educational services for children with disabilities. Many of these cases were based on the equal protection clause of the 14th amendment to the U.S. Constitution.

The complexity found in special education governance is reflected in the variety of funding sources and financing structures used. A clear understanding of the relevant laws, rules, and regulations that influence special education governance is a prerequisite to making sense of special education finances.

Soon after the codification of Section 504, in 1975, the U.S. Congress passed the Education for All Handicapped Children Act (Public Law 94-142), a grant statute, to provide expanded financial resources to states and local school districts to assist in the provision of special education services. Through subsequent amendments and reauthorization, Public Law 94-142 came to be known as the Individuals with Disabilities Education Act (IDEA) in 1990. IDEA covers individuals ages 3 to 21 who are determined by a multidisciplinary team to

be eligible within one or more of 13 specific categories of disability and who need special education and related services. Some noteworthy provisions of the law include:

- All children must be afforded an equal education opportunity and discrimination based on disability is prohibited.
- An individualized education plan (IEP) must be developed for each child requiring special education services.
- Each child with a disability is entitled to a free appropriate public education (FAPE). This means that special education must be provided at no cost to parents, must meet state standards, and must align with the student's IEP.

In addition to IDEA (reauthorized in 2004), the 2001 No Child Left Behind Act (NCLB), also a grant statute, influences special education in states and districts. This law requires states to assess all students annually using valid instruments accessible to the widest possible range of students. Student achievement data is required to be reported by subgroups (e.g., various ethnic groups, English language learners, and special education) and is used to determine whether schools or districts are making adequate yearly progress. The increased account-

ability provisions required of NCLB were accompanied by a substantial, but insufficient for many observers, amount of new federal resources.

Special education is also covered by the Americans with Disabilities Act of 1990, another major anti-discrimination law. Title II of the Act prohibits discrimination on the basis of disability in services by state and local governmental entities, whether or not they receive federal funds. The Act requires that public entities make reasonable accommodations in policies, procedures, or practices to avoid discrimination on the basis of disability.

Michigan Laws, Rules and Regulations

Michigan's commitment to special education is grounded in a strong foundation. Article VIII, Section 8 of the 1963 Michigan Constitution ensures that educational services and programs for the disabled will always be fostered and supported. Among the other states in the country, Michigan has a history of being a forerunner in special education. Public Act 198 of 1971 was one of the seminal laws, state or federal, in the United States to mandate special education for children with disabilities. It preceded one of the earliest federal laws (Education

The Important Role of ISDs in Special Education

Intermediate school districts (ISDs), sometimes alternatively called regional educational service agencies (RESA), educational service districts (ESD) or educational service agencies (ESA), are units of local government separate from local school districts. For purposes of this report, the generic term ISD is used to describe all types. Michigan's 57 ISDs were formed in 1962 under state law by reorganizing the previous 83 county-based school districts. The geographic boundaries of the 57 ISDs do not overlap, but combined, they cover the entire state. These entities have taxing authority under state law, separate from local school districts.

The roles and responsibilities of individual ISDs vary across the state. The mission and roles of ISDs are largely formed by local districts within their geographic boundaries. Many concentrate on supplying services to local constituent districts, including accounting and auditing of student counts, career and technical education, general education, and professional development. Despite the statewide variation, all ISDs are responsible for special education. State law is permissive with respect to all other ISD services except special education. Districts are mandated to deliver special education to eligible resident students. The Revised School Code (Public Act 451 of 1976) and the Michigan Administrative Rules for Special Education require ISDs to develop, establish, and continually evaluate and modify a plan for special education within their boundaries. This is the operational plan that sets forth programs and services to be delivered. All 57 ISDs work with their constituent districts in this process. Each ISD is required to submit its plan for special education to the Superintendent of Public Instruction, the chief executive officer of the Michigan Department of Education.

The special education plan outlines the programs and services available to students with disabilities residing within the ISD's boundaries. No two plans are exactly the same, although there are some similarities across plans because of requirements contained in state law. In broad terms, plans must describe the services directly provided by or purchased by each constituent local district and the services directly provided by, purchased by, or available through the ISD. These plans include descriptions of outreach methods to let citizens know about all available special education programs, descriptions of diagnostic and related services, confidentiality insurances for special education students, the identities of ISD and district employees charged with the implementation of special education programs, and a discussion of transportation responsibilities. Each plan must contain a description of the method of distributing special education funds.

While the special education plan is the responsibility of an ISD, in most cases the services are jointly provided by the ISDs and their constituent districts. With respect to services and programs, there is no model ISD in the state. Considerable variation exists across the state and the mix of services depends largely on student and local district needs. Even among ISDs that are similar from a descriptive standpoint (e.g., number of students, geography, etc.), districts are very different in the mix of special education services and programs available and how the responsibility is shared between the ISD and the local districts. For example, services provided at the ISD level in one area of the state may be delivered by local districts in another area of the state.

for All Handicapped Children Act of 1975) that carried the same mandate. Today, federal law (Individuals with Disabilities Education Act or IDEA) serves as the baseline for special education and related services throughout the states. IDEA establishes the minimum standards that states must meet.

The Michigan Administrative Rules for Special Education articulate the various requirements contained in Michigan law and IDEA. These rules also spell out where state requirements exceed the minimum standards established in federal law. Perhaps one of the most notable deviations from federal law is the Michigan requirement that special education is guaranteed to individuals through the age of 25, whereas IDEA requires services through the age of 21. State law guarantees general education services through age 20.

Michigan state government has ultimate authority over special education, in much the same way it has authority and responsibility over general education. This comes from various provisions contained in Michigan's 1963 Constitution. Similar to general education, the special education authority has been delegated to the local level where services are delivered through local education agencies (traditional public schools, charter schools, and intermediate school districts).

While local agencies are tasked with service delivery, state government (Michigan Department of Education) is responsible for monitoring service provision and compli-

ance with IDEA. A key task of the Department of Education is the issuance of an annual performance report that chronicles each district and service area's performance in meeting specific early intervention and special education targets outlined in the State Performance Plan required under IDEA.

State government also has a fiduciary responsibility with respect to administering approximately \$400 million of IDEA funding each year, nearly all of which is distributed to local education agencies. The Department of Education must ensure compliance with applicable federal rules attached to such funding. The Department distributes nearly \$1 billion in state resources to school districts to provide special education services.

Profile of Michigan's Special Education Population

According to the Michigan Department of Education in 2010, 226,680 students (about 14 percent of total) had an Individualized Education Program (IEP) and qualified for special education services and related programs.¹ These students were enrolled in traditional public school districts, public school academies or charter schools (also public schools), and ISDs.

Special education students were unevenly distributed among Michigan's local and intermediate school districts. The percentage of students with IEPs among the traditional public school districts (with enrollment over 100

Special Education Head Count and FTE

Two different pupil counts are used in special education finances. The number of students with an IEP (head count) is different than the special education full-time equivalent or FTE count. Each count is used for different purposes and acquired through different methods.

The FTE count is based on a student's full-time assignment to a special education classroom and is taken twice a year (fall and spring). Because most students with IEPs are integrated into the school environment and spend some time in a general education classroom they are only partially counted as a special education student in the FTE count (and the remainder is counted in the general education FTE count). Thus, the number of FTE special education pupils will be a fraction of the special education head count. The FTE count is used to distribute state aid through the per-pupil foundation program.

On the other hand, the special education head count is used for federal funding purposes and occurs once a year in the fall. This count is based on the number of pupils determined to be eligible for special education programs and services by disability. Each student is counted only once and represents a full person, regardless of the setting in which they are educated. For FY2011 (December 2010 count), Michigan's special education head count was 226,680 compared to a FTE count of 72,069.61. Based on these numbers and the 226,680 students with IEPs, approximately 154,611 FTE (more than two-thirds of the total) were counted in the general education setting.

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students) ranged from 4 percent (Nottawa Community School in St. Joseph County ISD) to 29 percent (Redford Union School District in Wayne RESA). There were 551 traditional districts (non-charter) in 2010. Even districts of similar overall size and demographic composition had very differently sized special education populations. For example, 13 percent of the students at South Redford School District in Wayne County had IEPs compared to 29 percent of the students at nearby Redford Union School District in 2010.

In the charter school environment, the range of students with IEPs (as a percentage of total K-12 enrollment) was also uneven. In 2010, the concentration of students with IEPs in charter schools ranged from 0 percent in two fairly small schools (Blue Water Learning Academy in St. Clair County RESA and Japanese American School of South East Michigan in Wayne RESA) to 42 percent (St. Clair County Learning Academy). Among all the charter

schools in the state (247 schools in 2010), disabled students accounted for 10 percent of all students enrolled in 2010.

Students receiving special education services ranged in age from birth to 26 years old. Federal law requires states to provide services from birth until the individual reaches age 21, but Michigan law extends this requirement to age 26. State law allows school districts to count in their membership (for state aid purposes) all special education students below the age of 26. In contrast, the State School Aid Act allows districts to count general education pupils between 5 and 20 years of age, with certain exceptions.

Two-thirds of the students with IEPs were male, compared to 51 percent of the total K-12 student population. The race/ethnicity distribution among special education students roughly mirrored that of the public K-12 popu-

What is an IEP?

As the name suggests, an Individualized Education Program (or IEP), is a student-specific, unique document designed to meet the educational needs of each child that has a disability. An IEP is a prerequisite to receive special education and related services and is mandated under Part B of the federal Individuals with Disabilities Education Act (IDEA). According to the U.S. Department of Education, "The IEP creates an opportunity for teachers, parents, school administrators, related services personnel, and students (when appropriate) to work together to improve educational results for children with disabilities. The IEP is the cornerstone of a quality education for each child with a disability."*

Development of an IEP is a multi-step endeavor carried out by a team of school personnel, parents, specialists, and the individual student, if appropriate. The IEP team is involved in a variety of activities, including child identification, disability identification, child evaluation, and eligibility determination. While the specific disability identification is a key ingredient to IEP development, the disability, by itself, does not limit the services available to the child. The next steps include the initial IEP meetings followed by writing the actual IEP document. Services are then provided consistent with the document. Progress is measured and reported to all parties involved at least annually. The IEP must be reviewed annually and each child must be reevaluated at least once every three years.

Federal law requires that IEPs include information about the child and the education program designed to meet their unique needs. Topics addressed in each IEP include current performance, annual goals, special education services, state testing participation, transitional services, and progress tracking and reporting. Key considerations in the development of an IEP include how the child will advance toward annual goals; be involved in general curricular activities; participate in extracurricular activities; and be educated with other children with disabilities and non-disabled students.**

* U.S. Department of Education, Office of Special Education and Rehabilitative Services. "A Guide to the Individualized Education Program." July 2000. www2.ed.gov/parents/needs/speced/iepguide/iepguide.pdf

** National Center for Learning Disabilities. "What is an IEP." February 24, 2009. www.nclld.org/at-school/your-childs-rights/iep-aamp-504-plan/what-is-an-iep

lation of the state. White special education students accounted for 70 percent of the total, Black or African American students for 21 percent, and students of Hispanic origin accounted for almost 6 percent.

As a group, students with IEPs were poorer than the overall K-12 population. In 2010, a larger share of the special education student population (58 percent) was eligible for free or reduced-price lunch under the criteria set by the National School Lunch Program, compared to the total K-12 population (46 percent).

Under federal law, a student must meet the criteria for one of 13 different disabilities to be eligible to receive special education services.² For 2010, the distribution of students with IEPs by disability category is shown in **Chart 1**. Two categories (specific learning disability and speech/language impairment) accounted for a combined 60 percent of the total special education student identifications. The third largest category, representing 10 percent of the total, is cognitive impairment, followed by other health impairment, which accounted for 9 percent. In total,

four of five special education students received services associated with these four disabilities.

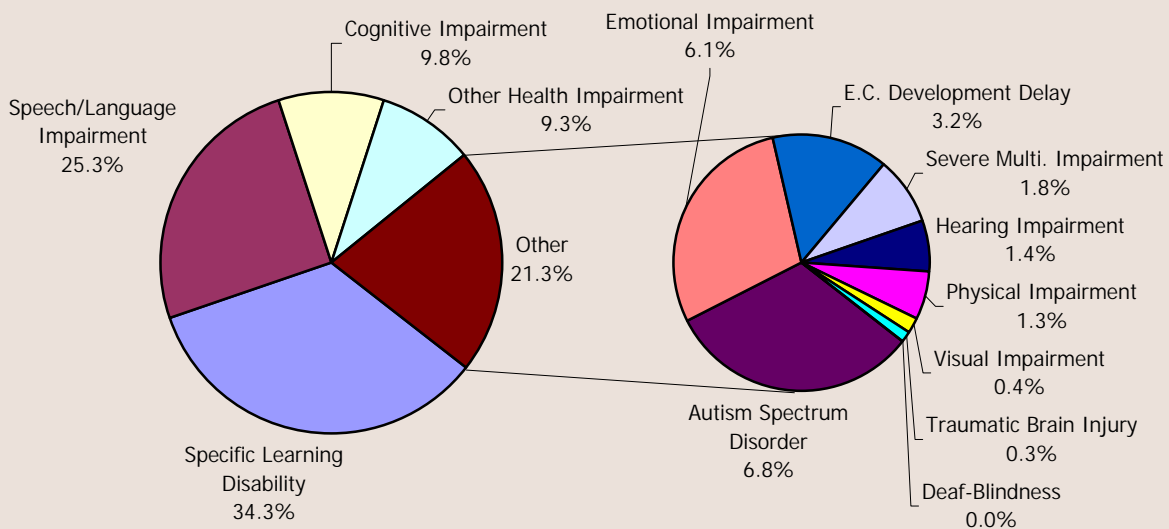
The number of disabled students receiving services statewide has changed from year-to-year with changes in overall enrollment. Compared to the statewide student head count in 2000, the total number of students with IEPs in 2010 is basically unchanged (approximately 227,000 students). However, over the intervening 10-year period there were two trends in the statewide numbers.

Initially, the number of special education students increased annually through 2005, rising to 250,769 students. Since 2006, the number of students with IEPs has declined each year and fell to 226,680 in the fall of 2010.

Not surprisingly, the number of disabled students receiving services statewide has changed with the changes in overall K-12 enrollments. K-12 enrollment is a function of birth rates and net migration. The number of Michigan births each year has been trending down for some

Since 2006, the number of students with IEPs has declined each year and fell to 226,680 in the fall of 2010.

Chart 1
Students with IEPs by Disability Classification in 2010



Source: MDE, Michigan Compliance Information System, Data Portrait

Table 1
Special Education Enrollment Changes in Traditional Public Schools

	<u>2000 to 2005</u>	<u>2005 to 2010</u>	<u>2000 to 2010</u>
Districts with Increased Enrollment	365	105	207
Districts with Decreased Enrollment	157	432	334
No Change or Not Reported	26	11	8

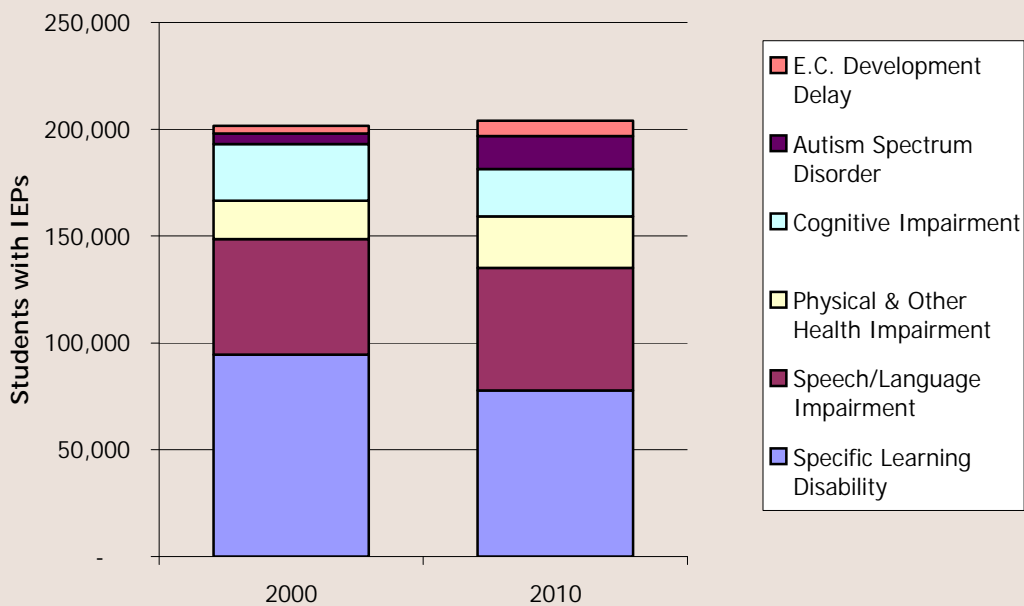
Source: Center for Educational Performance Information (CEPI)

time. At the same time, Michigan's struggling economy has contributed to negative net migration for most of the last decade. The broad trends in special education enrollments generally mirror the changes observed in the total K-12 student population over the last ten-year period. The one key difference is that the decline in the overall K-12 population occurred earlier than the year-over-year decline in the special education population. The total statewide K-12 student count increased each year through 2003. Since 2004, the overall K-12 enrollment has declined every year. Unlike the special education student population which had about the same number

of students in 2010 as it did in 2000, the total K-12 population is down 6.3 percent from 2000 to 2010.

The experiences at the individual district level (traditional public schools) are similar to what is observed with the state-level data.³ Initially, from 2000 to 2005, more districts experienced special education enrollment increases than losses (See **Table 1**). However, over the most recent period this trend reversed itself and more districts have experienced enrollment losses than enrollment gains. Over the entire 10-year period, about 40 percent of districts had some amount of enrollment gain.

Chart 2
Change in Mix of Largest Disability Identifications: 2000 to 2010



Sources: MDE, Michigan Compliance Information System, Data Portrait

Table 2
Student Head Count by Type of Public School: 2000 and 2010

<u>School Type</u>	<u>2000</u>		<u>2010</u>	
	<u>Special Education Students</u>	<u>As Percent of Total K-12 Enrollment</u>	<u>Special Education Students</u>	<u>As Percent of Total K-12 Enrollment</u>
Traditional Public Schools	209,581	13.0%	184,869	12.8%
Charter Schools	2,961	5.4%	10,297	9.7%

Source: CEPI

While the total number of students with IEPs has not changed substantively compared to 2000, the distribution of students by disability has changed in a few major categories. Specifically, the number of identifications of autism tripled from roughly 5,000 students in 2000 to 15,000 students in 2010 while the number of early childhood delays doubled from about 3,500 students to nearly 7,200 over the same period (See **Chart 2** on page 7). Two of the three largest disability groups in 2000 and 2010, specific learning disabilities and cognitive impairments, decreased by 18 percent (about 17,000 students) and 16 percent (4,300), respectively, between 2000 and 2010. The changes in these historically large categories account for nearly all of the observed distribution variation over the 10-year period.

Enrollment by Type of District

Under federal law, public schools throughout the United States have a responsibility to provide a free and appropriate public education to children with disabilities in the least restrictive environment. Charter schools in Michigan (known as public school academies or PSAs) are considered public schools under provisions of the 1963 Michigan Constitution and state law and must adhere to federal and state special education laws. Therefore, the same special education laws, rules, and regulations that apply to traditional public schools also apply to charter schools. Although many charter schools require students to apply for admission, schools may not categorically deny admission to students on the basis of disability. Once enrolled, a special education student is entitled to all the services required by his/her IEP. The charter school, like

a traditional public school, is responsible for operating or contracting out the services and programs within the context of the ISD special education plan.

Just as general education students are enrolled in both traditional public and charter schools, students with IEPs also attend both types of public schools. However, proportionately more students with disabilities are found in traditional public schools compared to charter schools. In 2010, 12.8 percent of the total K-12 students in traditional public schools had IEPs (See **Table 2**). This compares to 9.7 percent of the total K-12 students in charter schools.

In contrast to the decline in the traditional public school setting, the number of students with IEPs in charter schools more than tripled between 2000 and 2010. Much of this change was attributable to the growth in the number of charter schools and charter enrollment.

Compared to 2000, the statewide concentration of disabled students in the traditional public school environment in 2010 was relatively unchanged at 13 percent. (Between 2000 and 2010 the concentration peaked at 14.2 percent in 2006). Compared to 2000, the number of students with IEPs in traditional schools in 2010 was down

nearly 25,000; however, the total K-12 enrollment in traditional districts also was down proportionately. Therefore, as a percentage of the total, the number of students with IEPs in traditional schools in 2010 was the same as it was in 2000.

In contrast to the decline in the traditional public school setting, the number of students with IEPs in charter schools more than tripled between 2000 and 2010. Much of this change was attributable to the growth in the number of charter schools and charter enrollment. Although charter schools were authorized in the mid-1990s, growth in the number of charters and student enrollments did not occur until the early 2000s. Steady growth contin-

Table 3
Percentage of Special Education Students by Disability in 2007

<u>Disability</u>	<u>Traditional Public Schools</u>	<u>Charter Schools</u>	<u>“Cluster District”*</u>
Specific Learning Disability	36.0%	43.0%	38.3%
Speech/Language Impairment	24.8%	30.4%	19.8%
Cognitive Impairment	10.5%	8.2%	15.3%
Physical Impairment	8.1%	7.5%	5.9%
Emotional Impairment	7.0%	5.2%	6.6%
Autism Spectrum Disorder	5.2%	2.9%	3.9%
All Other Disabilities	8.4%	2.8%	10.2%

* There were 20, mainly urban, districts included in the “cluster district” because these districts contained three or more charter schools.

Source: Michigan Department of Education (MDE), 2008 PSA Report to the Legislature

ued throughout the 2000s until today. Recent state law changes allowing for a greater number of charter schools is likely to accelerate the charter enrollment growth in the coming years. Between 2000 and 2010, the number of charter schools increased substantially, as did the total enrollment in these schools (slightly more than double). Over the same period, the percentage of students with IEPs increased from 5.4 percent to 9.7 percent. As the overall charter school enrollment grew over the last decade, a greater proportion of students with IEPs chose this educational alternative.

Although charter schools serve proportionately fewer special education students than traditional public schools (about three percentage points), the distribution of these students (by disability) was roughly the same in 2007 (most recent data) in both settings (See **Table 3**). There also was little difference between charter schools as a whole and the comparison “cluster district”. A “cluster district” is a subset of traditional public school districts that is intended to reflect areas where charters are in relatively high demand. Use of the “cluster district” is intended to provide another point of reference for comparing charters with traditional public schools because the student populations of these dis-

tricts more closely approximate that of charter schools than does a statewide average. The “cluster district” subset was comprised largely of urban districts with three or more charters. Neither the statewide average nor the “cluster district” is an ideal statistical measure, but used together they can provide for a more informed comparison.⁴

Since the 1970s, laws, rules, and regulations have placed a premium on ensuring access to and progress in general education curriculums and settings, a concept referred to as “mainstreaming.” Given this emphasis, it is not surprising that the vast majority of special education students spend at least a part of their school day in a general education classroom, often aided by appropriate supplemental resources when needed.

Where Do Special Education Students Receive Services?

Special education services, which vary depending on the student, are delivered in a variety of settings, including, but not limited to, home/residential, early education, general education, special education, traditional public schools, and charter schools. A guiding principle contained in federal and state laws is that students should be educated and receive services in the least restrictive environment (LRE). This is designed to ensure that students are not unnecessarily segregated from the general education population and to minimize any stigma that might be associated with special education. Since the 1970s, laws, rules, and regulations have placed a premium on ensuring

access to and progress in general education curriculums and settings, a concept referred to as “mainstreaming.” Given this emphasis, it is not surprising that the vast

majority of special education students spend at least a part of their school day in a general education classroom, often aided by appropriate supplemental resources when needed. For a small fraction of the special education population, students are served entirely within a special class designed for students with disabilities. Such placements are based on a student's IEP and typically reserved only for those with severe disabilities and those with the most significant special needs.

Statewide in 2010, nearly two-thirds of the students with IEPs between the ages of 6 and 21 spent 80 percent or more of their time in a general education setting (See **Table 4**). The remainder of their school day was spent

in a designated special education setting, which might be in their local school district, another local district, or at the intermediate school district. About 93 percent of all students spent some amount of their school day in a general education classroom. Approximately 5 percent of students, per their IEPs, received all their education and related services in a designated special education setting. This distribution varied by local district and in some cases quite considerably. For example, only 38 percent of Detroit Public Schools' special education students spent 80 percent of their time in general education classrooms compared to 69 percent in Dearborn Public Schools.

Table 4
Educational Setting of Students with IEPs Age 6-21 in 2010

<u>Educational Setting</u>	<u>Number of Students</u>	<u>Percent of Total</u>
General Ed >= 80%	120,692	62%
General Ed 40% to 79%	37,025	19%
General Ed <= 40%	24,456	12%
Special Ed Building	9,518	5%
Other*	4,083	2%
Total	195,774	100%

* Other includes residential, correctional, juvenile detention, hospital or home setting.

Source: MDE, Michigan Compliance Information System, Data Portrait 2010.

Special Education Finances

Michigan's current special education financing system has its roots in both Proposal A of 1994 and the Supreme Court's 1997 *Durant* decision. Both Proposal A and *Durant* are responsible for governing the state and local resources available. State aid and local property tax revenues contribute about equally to the financing of special education statewide and represent the two largest funding sources, while federal dollars and general funds (from local districts and ISDs) are the other two main sources of funding. In general, the Proposal A reforms established limits (as to base and rate) on local property taxes earmarked for special education, while the *Durant* decision established the state's role in financing special education. Because of their primary roles, all major issues surrounding special education finances, at least on the revenue side, generally touch upon either the dedicated local property tax or state aid. Federal mandates and the less-than-full

amount of funding supplied to states also contribute to the challenges of providing special education. Finally, school districts' general funds serve as the "funders of last resort", responsible for meeting any remaining obligations not covered by dedicated federal, state, and local resources. Special education's use of general funds create pressures on the finances for general K-12 funding.

A Complex System

Financing primary and secondary education is a complex endeavor. Similarly, as a key component of, but in many respects separate from K-12 finances, special education finances are exquisitely complex. Special education finance consists of a maze of state and federal laws, rules and regulations, and complicated formulas that govern

Proposal A: What Are We Talking About Here?

On December 24, 1993 the legislature adopted a complex plan to restructure the funding of public K-12 education. The plan consisted of a ballot proposal to amend the 1963 Constitution, together with implementing legislation, and an alternative statutory plan which would take effect if the ballot proposal was rejected. Voters cast a single vote to choose between two similar reforms, neither of which involved a continuation of the current education finance system. The ballot proposal (designated as Proposal A by state election officials) was submitted to voters at a special election on March 15, 1994, amending several constitutional provisions:

- Permit school operating taxes to be imposed on a non-uniform basis.
- Limit 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.
- Increase the sales tax rate from 4 to 6 percent, beginning May 1, 1994. The additional revenue from the sales tax would be dedicated to the School Aid Fund.
- Require 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.
- Require a three-fourths vote of the legislature to increase school operating taxes beyond those in effect February 1, 1994.

The major difference between the two approaches was that Proposal A and its implementing legislation relied primarily on a sales tax increase, while the statutory alternative plan relied primarily on increases in the individual income tax and the Single Business Tax. The proposed sales tax increase required voter approval because the rate is limited in the state Constitution, while the legislature was authorized to increase the income tax and the Single Business Tax rates statutorily.

The term "Proposal A" and references to it can lead to confusion because of the different ways in which the term is employed. In a strictly historical context, Proposal A refers to the March 1994 statewide ballot proposal to amend the 1963 Constitution to implement certain components of the new K-12 education finance system. For the purposes of this report, the term "Proposal A" is used more generically to describe the entire education financing system created as a result of both the constitutional amendment and the related statutory changes.

the resources used by local and intermediate school districts to deliver special education programs and needed services to individuals with disabilities. Unlike general K-12 finances that have been centralized at the state government level through the Proposal A of 1994 school finance reforms, special education largely remains a local responsibility at the ISD level, where local property taxes continue to play an important role. The complex nature of special education is reflected in the governance structures (federal, state, ISD, local schools, etc.) as well as the financing system. Compounding the complexity found in governance and financing structures is the fact that the special education student population tends to be much less homogenous in terms of educational needs compared to general K-12 students.

The complexity found in special education arises from a number of factors, with the single largest factor arising from the non-uniformity found throughout the finance system. This non-uniformity originates with the individuals participating in related programs and receiving services. Children, teens, and young adults with disabilities have varying educational needs that local and intermediate school districts are mandated by state and federal laws to meet. This requires a unique mix of services centered on the individual student. Unlike the general education financing system that largely views students and their educational needs as homogenous, the special education finance system takes a distinctly individualized approach, beginning with each student's unique IEP.

Also, each of Michigan's 57 ISDs is responsible for a special education program and service delivery plan, commonly referred to as the special education plan. These plans are locally-determined and developed with state oversight. While there are similarities across ISD plans, each one is unique. The same services may be available under two different plans but the entity responsible for service provision (local constituent district versus ISD) may be much different when comparing the two plans.

Contributing to the non-uniformity across districts is the fact that special education finances are still largely con-

trolled at the local level, whereas general education finances are determined by the state government. While special education students participate in the state's per-pupil foundation program, which determines the amount of general education revenues, local and intermediate school districts have the ability to determine, through separate voter-approved millages, the amount of funding available to deliver special education programs and services. Largely as a result of these local tax decisions, property tax wealth disparities and differences in millage rates, the total amount of revenue per special education student can vary substantially across the state.

Finally, special education revenues originate from all three levels of government (federal, state, and local). Federal resources play a much larger role (proportionately) in special education than they do in general education. Accompanying each funding source is often a separate set of rules that govern the use of the money.

Special Education Spending: A Statewide Perspective

Table 5 on page 13 presents a 10-year history of annual statewide special education expenditures. Expenditures were used to employ special education teachers, related service providers, and special education administrators (salaries and benefits for these individuals), as well as transportation services and non-personnel items (materials, supplies, technology) purchased for related programs. What is not included in these figures is the general education spending that might be related to special education students participating in a general education classroom. Recall, many special education students spend time in a general educational setting. Thus, the figures presented here represent *total special education spending* as opposed to *total spending required to educate a student with a disability*. It is also important to recognize that the expenditure data, and changes over time, reveal nothing about the results associated with special education services and programs delivered by schools. Expenditures merely measure the flow of dollars, not what is being purchased with those resources.

While there are similarities across ISD plans, each one is unique. The same services may be available under two different plans but the entity responsible for service provision (local constituent district versus ISD) may be much different when comparing the two plans.

Table 5
Statewide Special Education Expenditures: FY1998 to FY2010
(Dollars in Millions)

<u>Fiscal Year</u>	<u>State-Reimbursable Expenditures*</u>	<u>Federal Expenditures</u>	<u>Total Expenditures</u>	<u>Annual Percent Change</u>
2000	\$1,921.3	\$201.3	\$2,122.6	7.8%
2001	2,053.5	222.1	2,275.6	7.2%
2002	2,140.0	262.6	2,402.6	5.6%
2003	2,267.9	300.5	2,568.4	6.9%
2004	2,365.6	348.4	2,714.0	5.7%
2005	2,467.2	440.9	2,908.1	7.2%
2006	2,580.4	458.2	3,038.6	4.5%
2007	2,666.7	456.8	3,123.5	2.8%
2008	2,757.1	462.0	3,219.1	3.1%
2009	2,802.2	481.6	3,283.8	2.0%
2010	2,660.0	735.0**	3,395.0	3.4%
Percent Change from FY2000 to FY2010	38.4%	265.1%	59.9%	
Average Annual Growth Rate from FY2000 to FY2010	3.3%	13.8%	4.8%	

* Expenditures eligible for state reimbursement pursuant to the State School Aid Act in accordance with the Michigan Supreme Court's decision in *Durant*.

** The large increase in expenditures financed with federal dollars in FY2010 is attributable to the one-time American Recovery and Reinvestment Act of 2009 funding provided through the Individuals with Disabilities Education Act, Part B. A significant portion of Michigan's \$400 million award was spent in FY2010.

Source: MDE, Special Education Actual Cost Report (SE-4096) and Transportation Expenditure Report (SE-4094); CRC Calculations

In FY2010, school districts reported \$3.4 billion in combined special education expenditures, up 60 percent from the amount in FY2000.⁵ Significant annual increases from 2000 to 2006 (between 6 and 8 percent annually) were accompanied by the growing special education population. When the number of students with IEPs began falling in 2006, the annual growth rates moderated. Over the entire period, total spending increased, on average, 4.8 percent per year. This annual growth rate was double the annual increase in inflation (U.S. Consumer Price Index) over the same period, which averaged 2.4 per-

cent. (If the one-time federal stimulus funds received in FY2010 are ignored, total ongoing expenditures increased by 48 percent since FY2000 or 4.0 percent per year on average.)

Another way to examine special education spending is to compare it to total K-12 spending in the state. General Fund operating spending by local districts (excluding intermediate school districts) includes instructional expenditures (basic, added need, and adult education), support instructional services, and non-instructional services (administration, transportation, and facilities). It does not include capital outlay or debt service expenses. In FY2010 expenditures totaled \$15.1 billion, nearly three times the amount spent on special education alone. Compared to FY2000 (\$12.4 billion General Fund expendi-

tures), total K-12 spending in FY2010 was up 21 percent, which was below the growth in inflation and well below the growth in total special education spending over the same period (60 percent).

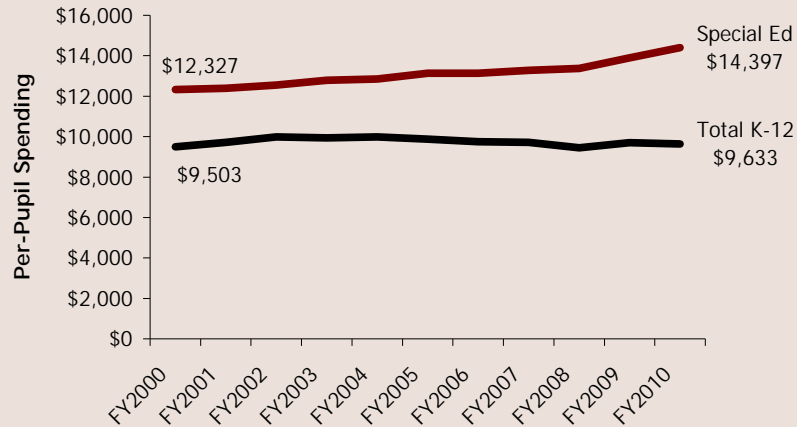
Total K-12 General Fund spending increased despite a 6.3 percent drop in the number of pupils from FY2000 to FY2010. The reduction in the total K-12 population caused the per-pupil spending amount to increase at a rate that slightly exceeded inflation from FY2000 to FY2010. Despite the growth in the number of special education stu-

dents over the 10-year period, per-pupil special education spending still outpaced inflation from FY2000 to FY2010. **Chart 3** compares the growth in per-pupil special education spending to per-pupil K-12 spending. In real (FY2010) dollars, per-pupil special education spending increased nearly 17 percent between FY2000 and FY2010 compared to a 1.4 percent increase in total K-12 per-pupil spending over the same period.

Over the last ten years, special education spending grew faster than overall K-12 spending, both in the aggregate and on a per-pupil basis. Further, this spending exceeded changes in inflation. A key factor in this growth was the steady increase in enrollment. Another likely factor that contributed to this growth is the higher costs associated with delivering special education services and running related programs. These costs are driven by smaller class sizes, the need for special education aides in the classroom, the rising number of specialists, and the costs of diagnostic and professional support services (nursing and various therapies).

Another factor that explains the growth in spending stems from the very structure of the state aid system designed to finance a portion of the expenditures incurred by local and intermediate school districts. Under this system, there is no incentive to control costs at the local level. As a result of the Michigan Supreme Court's landmark *Durant* ruling in 1997 (discussed later), the state is constitutionally obligated to pick up at least 29 percent of direct costs and 70 percent of transportation costs. The total state reimbursement each year is uncapped because the state is responsible for these fixed percentages. The state's responsibility does not change with the fiscal condition of either the General Fund or the School Aid Fund, the two major state funds.

Chart 3
Total K-12 and Special Education Per-Pupil Spending



Source: MDE, Bulletin 1011, Report SE-4096, and Report SE-4094; CRC calculations

Special and General Education Spending Comparisons

Researchers, policymakers, parents, and school personnel often ask what differences, if any, exist between the finances of special education students and general education students. At the national level, the U.S. Department of Education does not collect data specifically on special education spending per se. Federal K-12 finance data does not break out revenue and spending separately for special and general education. In Michigan, state law does require the collection of specific special education expenditures to provide state reimbursement; however, no data source exists that covers only general education spending. Instead, the available statewide data covers all K-12 spending and revenue combined (special, general, and vocational education). Also making comparisons difficult is the fact that no central data source provides a complete picture of the various special education revenues (federal, state, and local). Therefore, data availability makes a clean,

Over the last ten years, special education spending grew faster than overall K-12 spending, both in the aggregate and on a per-pupil basis.

straightforward comparison of special and general education finances very difficult; both across states and within Michigan, specifically. Various special studies and surveys have attempted to address this data void; however, they have their limitations.

A few studies have shown the degree to which per-pupil special education spending exceeds the per-pupil spending for general education students. Studies also have shown the per-pupil spending differences required to meet the educational needs of students with various disabilities. In some cases, the per-pupil difference between general and special education spending is relatively small, but in other instances the differences are quite substantial (up to 8 times for visually impaired individuals).

A major national study (published in 2004) attempted to answer the broad public policy question “What are we spending on special education services in the U.S.?” This study found that the additional per-pupil spending to educate the average student with a disability was \$5,918.⁶ This was the difference between the total expenditure per special education student (\$12,474) and the total expenditure per general education student (\$6,556).

Presented as a ratio, per-pupil special education spending to per-pupil general education spending was estimated to be 1.9. Alternatively stated, this data suggests that the nation spent 90 percent more on a special education student than a general education student. This ratio was down from 2.28 in 1985 that was reported in a similar national study.

The main finding presented in the national data is confirmed in a report prepared by the Michigan Department of Education in 2008 based on detailed special education spending in FY2007.⁷ The Michigan study calculated a statewide average cost per special education pupil. The study also calculated an average cost per student by disability type for those students that spent all of their day in a special education classroom. In each case, these figures were compared with the average statewide K-12 per-pupil cost for all students (general and special education students) published in annual Department of Education reports. Major findings from this report are presented here.

- On a full time equivalency (FTE) basis, for students that spend all day in a special education classroom,

Per-pupil expenditures ranged from a low of \$10,558 for students with specific learning disabilities to a high of \$20,095 for students with multiple disabilities.

the average cost was \$22,155. (As noted earlier, few students spend all their time in designated classroom, thus the need to use FTE as opposed to head count data to arrive at an average.) The cost varied considerably by type of disability. The range was \$12,082 for those with disabilities in early childhood settings (mostly half day programs) to \$73,475 for students with visual impairments.

- For students that only received a related service (i.e., not assigned entirely to a special education classroom) and spent the entire day in K-12 classrooms, the average cost was \$5,062. Again, using the FTE basis, this figure represented the additional cost above the general education costs associated with these special education students.
 - The average cost of a special education student was calculated by dividing the total special education costs (including transportation spending) reported to the Department of Education by the total head count (unduplicated). This yielded an average figure of \$12,544 in FY2007, compared to an average statewide K-12 per-pupil cost of \$9,177 (special and general education students).
- The ratio between the per-pupil spending average for special education students and the per-pupil average for all K-12 students was 1.4 (\$12,544/\$9,177) using the head count. It is important to note that this ratio compares average per-pupil spending for a special education student with the average per-pupil spending for all elementary and secondary students (special and general education). Unlike the national study discussed earlier, state data do not exist to calculate the per-pupil spending for general education services only. Thus, the ratio is somewhat lower.

The spending variations by disability found in Michigan are consistent with data from a national study. Per-pupil expenditures ranged from a low of \$10,558 for students with specific learning disabilities to a high of \$20,095 for students with multiple disabilities. Nationally, as is the case in Michigan, the highest incidence disability categories exhibit the lowest amounts of per-pupil spending. Students with specific learning disabilities and speech/language impairments account for nearly two-thirds of the students who receive services, but the per-pupil spending was \$10,558 and \$10,958, respectively.⁸

Per-Pupil Spending Differences across Districts

The amount of per-pupil special education spending, at both the local and intermediate school district levels, varies radically across the state. While Proposal A of 1994 sought to reduce the per-pupil funding disparities found in general education, these reforms did not endeavor to equalize per-pupil special education funding to the same degree. Further, the 1997 *Durant* court decision, which revolved around determining state government's responsibility to finance special education, did nothing to equalize per-pupil funding. Thus, spending variations across districts have lingered for some time and the difference between the highest and lowest spending districts has increased in recent years.

Per-pupil spending variations result from a number of factors, including those related to the student populations being served, such as the mix of students (by disability), the severity of students' disabilities, and the age of students in each locale. Another key factor is the number and type of services and programs offered locally, including an array of ancillary support services that districts may offer. Additionally, spending variations can be explained by the level of commitment and support for special education programs within individual communities. Often times, this support is reflected in the amount of per-pupil tax revenue generated by the local special education millage. Property tax yields are both a function of the tax rate chosen by local voters as well as the relative property wealth (measured as taxable value per

Reducing Per-Pupil Special Education Funding Disparities, What Will it Take?

In terms of general K-12 spending, prior to the adoption of Proposal A in 1994, the highest spending district outspent the lowest spending district by nearly a factor of four. Since the adoption of the foundation grant program, and as a result of steps taken to reduce general K-12 per-pupil spending disparities, the highest per-pupil grant is less than two times the lowest per-pupil grants.

The equity gains made with general K-12 per-pupil funding would not have been possible without the school finance reforms that centralized funding and financial decision making authority at the state level. Specifically, these reforms relied on reducing the reliance on local property taxes governed by local voters in exchange for state-level taxes (sales, income, cigarette) dedicated to schools. Further, financial decisions about per-pupil funding levels were moved to Lansing and taken away from local officials. With both the money and decision-making authority at their disposal, state officials were able to address the school funding disparities that had plagued policymakers for years.

Absent efforts to centralize special education financing (i.e., greater reliance on state taxes and away from local property tax, and shift decision making authority to state officials), reducing per-pupil special education spending differences is unlikely to occur. Under the current financing system, local property taxes play too significant of a role (almost 50 percent) and contribute substantially to per-pupil revenue disparities (discussed below).

Centralizing special education funding would require changes in one or more of the major state taxes. To illustrate the equivalent tax changes involved, replacing the nearly \$1 billion in annual property tax revenue statewide with a state-level tax would require:

- An increase in the state income tax rate of 0.6 percentage points (from 4.35 percent to 4.95 percent); or
- An increase in the state sales/use tax rate of 0.7 percentage points (from 6 percent to 6.7 percent), which would require a constitutional amendment; or
- An increase in the state education property tax of 3.5 mills (from 6 mills to 9.5 mills).

Raising the replacement revenue would be only one of the many steps involved in moving to a more centralized system. Perhaps the most challenging transition would involve determining what method to use to reduce per-pupil funding disparities. If the policy involved providing more resources to those at the bottom, then additional replacement revenues would have to be generated. Even more resources would be involved if all schools (not just those at the bottom) received annual increases. Proposal A reforms involved policies that "raised the bottom". An alternative method to achieve greater funding equity would involve reducing the funding provided to those at the top; however, this option would be extremely difficult to implement politically.

FINANCING SPECIAL EDUCATION: ANALYSES AND CHALLENGES

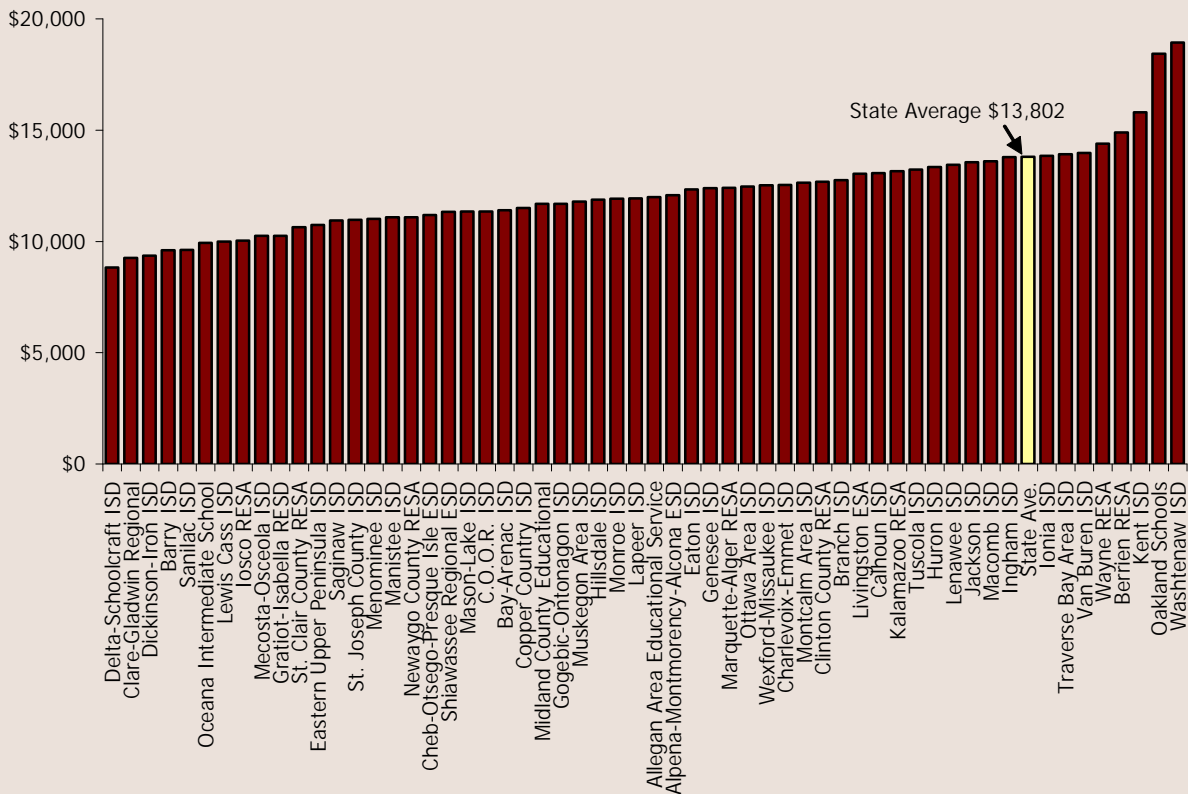
student) in the local community. Both of these factors will influence the tax yield.

In 2010, per-pupil special education spending (excluding transportation) averaged just over \$13,800 statewide. However, amounts among ISDs ranged from \$8,832 per pupil (Delta-Schoolcraft ISD) to \$18,932 per pupil (Washtenaw ISD).⁹ The highest amount was more than two times as much as the lowest. **Chart 4** shows the average per-pupil spending in FY2010 for all 57 ISDs and the statewide average. (The statewide average figure is closer to the highest amount rather than the median amount (\$11,921 in Monroe ISD) because a large number of students are enrolled in higher per-pupil spending districts. The higher concentration of students in a relatively few higher revenue districts increases the statewide average. For example, the six largest districts (number of special education students) have average per-pupil spending that ranks them in the top ten of all districts.)

Over the last four years, the disparities in funding at the extremes have grown. In FY2007, per-pupil spending ranged from \$7,798 (Iosco ISD) to \$15,572 (Oakland Schools), a difference of \$7,774. Between FY2007 and FY2010, the range (difference between highest and lowest) increased to \$10,100. The widening gap between the highest and lowest is further evidenced in the fact that the ratio of the two extremes increased from just below 2.0 in FY2007 to nearly 2.2 in FY2010. This suggests that the disparity in per-pupil spending, at least in the short term, has grown slightly.

The growing per-pupil spending disparity among districts contrasts with the experience in the general education setting over the same period. For general education students, the primary funding mechanism is the foundation allowance and the difference between the highest and lowest per-pupil grant shrank from \$5,231 in FY2007 to \$5,008 in FY2010. Over the same period, the ratio (high-

Chart 4
Per-Pupil Spending by ISD in FY2010



Source: MDE, Report SE-4096; Center for Educational Performance Information; CRC calculations.

est to lowest per-pupil grant) fell from 1.74 to 1.70. It is also worth noting that the ratio for general education funding is nearly 25 percent smaller than the ratio between highest and lowest spending districts in the special education setting, suggesting that the relative difference in special education spending is also greater.

These recent general education per-pupil equity gains were the result of state policymakers' explicit efforts to provide more funding to lower spending districts. A key policy objective of state lawmakers since Proposal A of 1994 has been to reduce per-pupil spending differences for general education, primarily by increasing the foundation grant amounts of lower spending districts. Most equity gains occurred in the years immediately following Proposal A's adoption in 1994; however, gains have been achieved in nearly every year since.¹⁰

Components of Special Education Spending

Local and intermediate school districts report the detailed components of their special education spending to the state annually. This information is used to provide reimbursement to districts for allowable costs under the State

School Aid Act and consistent with the parameters of the *Durant, et al v. State of Michigan, et al* (or simply *Durant*) Michigan Supreme Court decision which details the State of Michigan's responsibility in special education financing. (The *Durant* decision is discussed in more detail later in this report.) Per the *Durant* decision, districts are eligible for 28.6 percent of total approved direct special education costs (excluding the direct costs associated with certain special education students which are covered 100 percent) and 70.4 percent of the total approved special education transportation costs.¹¹ Because of *Durant*, direct costs and transportation costs eligible for state reimbursement are reported separately.

While transportation is an important service provided to both general and special education students, it is not a mandatory service under state law.¹²

Furthermore, compared to the direct special education costs, transportation represents only a small proportion of total spending. In FY2010, transportation spending accounted for less than 10 percent (\$249 million) of the total \$2.7 billion in state-reimbursable special education spending by districts, while direct costs totaled roughly \$2.4 billion.

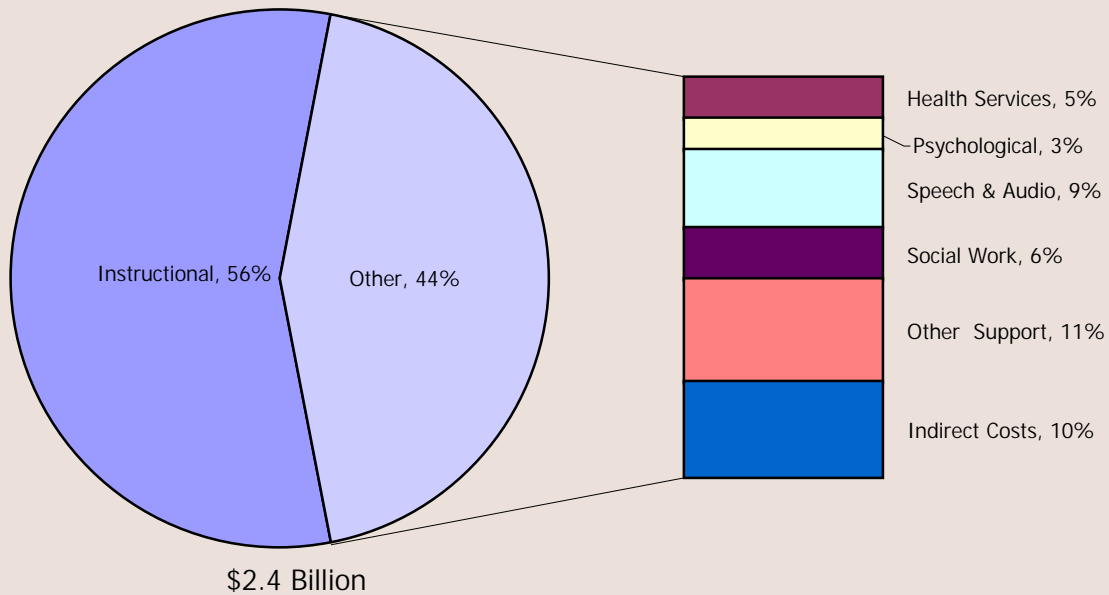
The growing per-pupil spending disparity among districts contrasts with the experience in the general education setting over the same period.

Spending By Function

Education, regardless of the setting, is a people-intensive endeavor. In much the same way that personnel costs (primarily salaries and benefits) drive general education spending, these costs also make up the vast majority of direct special education operating expenditures (\$2 billion or 85 percent of the total in FY2010). Also consistent across educational settings, the largest share of personnel costs can be found in the instructional category (primarily teachers and aides). In FY2010, instructional salaries and benefits accounted for \$1.3 billion, or two-thirds, of all special education personnel costs.

While instructional costs are the largest category (56 percent), other costs are incurred for services that might not be as common in the general education classroom. For example, school districts spend money on health services (physicians, physical and occupational therapists, nurses, etc.), psychological services, speech and audiology, social work services, and teacher consultants working with specific disabilities. The level of services and amount of spending in these major categories will vary across districts depending on students' IEPs and the ISD special education plan. **Chart 5** details the \$2.4 billion of direct special education spending that was eligible for state reimbursement in FY2010 (excluding transportation).¹³

Chart 5
Special Education Spending by Function in FY2010



Source: MDE, Report SE-4096 (state costs only)

Spending on Personnel

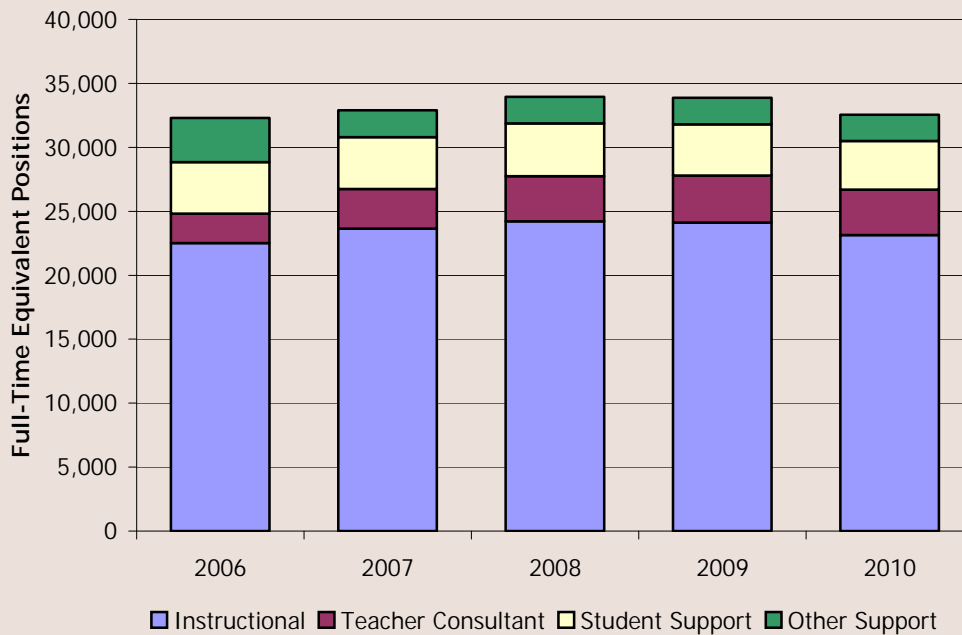
In December 2010 (2010-11 school year) there were 32,549 full-time equivalent (FTE) special education employees. This included instructional staff (teachers, aides), teacher consultant positions (disability-specific personnel), support personnel (social work, psychologist), and other special education support positions (therapists, audiologists). Combined, teachers and classroom aides accounted for approximately 71 percent of the total; teacher consultants and support personnel each made up 11 percent; and other support positions comprised 6 percent. **Chart 6** presents the composition of special education employment from 2006 to 2010, which has not changed substantively during this period.

In 2010, special education employees accounted for 17 percent of the total number of school employees, which was up from 15 percent in 2006. The rise in special

education's share of the total was primarily the result of general education employment levels dropping in response to falling state enrollments, as opposed to an increase in special education personnel. While special education employment was generally flat in 2010 compared to 2006, general education employment fell nearly 11 percent since 2006.

Over the same five-year period, the number of students with IEPs statewide was down 9 percent. As a result, the student to staff ratio in the special education setting decreased from 7.7 to 6.9 and the student to instructional staff (teachers and aides) ratio declined from 11.1 to 9.8. While special education students continue to represent about 14 percent of the overall student population in the state, special education employees are assuming a larger share of the overall K-12 education employment landscape. This was, and likely will continue to be, a cost driver facing districts.

Chart 6
Special Education Personnel: 2006 to 2010



Source: Center for Educational Performance Information, Registry of Educational Personnel

Spending on Transportation

If a district provides transportation services (directly or through contract) to non-disabled students, it must do so for students with IEPs. Although these services are not mandatory under state law, districts cannot discriminate in their provision. While the related costs represent a relatively small share of total special education expenditures (10 percent), transportation of disabled students tends to be more involved and therefore more expensive on a per-pupil basis when compared to the general education population. Statewide transportation costs for special education and general education for the last four-year period are compared in **Table 6**.

The average per-pupil transportation cost for those special education pupils receiving the service in FY2010 was \$6,393, compared to \$718 per pupil for general education students. This was likely the result of the additional time, personnel, and special equipment required to transport special education pupils. Also contributing to the cost premium is the fact that many special education students receive separate (dedicated) transportation services.

The average per-pupil transportation cost for those special education pupils receiving the service in FY2010 was \$6,393, compared to \$718 per pupil for general education students.

Although the number of riders trended down in both cases, the per-pupil cost rose substantially over the last four-year period because total expenditures did not fall proportionate to the number of riders (reflective of the general fixed cost nature of providing transportation). Higher fuel prices were partially responsible for the per-pupil cost increase; however, it was more likely that districts were unable to shed some of the fixed costs that would drive down total spending.

While only 17 percent of Michigan's special education population received transportation services in FY2010, the total and per-pupil costs were substantial (compared to general education) and created a financial strain on those districts that chose to provide the service. These costs rose despite fewer riders over the past four years. Transportation will continue to be a significant spending pressure on districts' budgets. However, districts do not have the option to eliminate transportation for one group of students (e.g., special education) and retain it for another (e.g., general education).

Therefore, transportation services is an either/or proposition for districts where the cost savings associated with service elimination would be substantial.

Table 6
Transportation Spending: FY2007 to FY2010

<u>Fiscal Year</u>	<u>Expenditures</u>	<u>Miles</u>	<u>Riders</u>	<u>Cost per Rider</u>	<u>Cost per Mile</u>
Special Education					
2007	\$247,579,938	58,180,650	44,561	\$5,556	\$4.26
2008	262,113,198	55,488,897	40,962	6,399	4.72
2009	253,350,540	55,425,993	41,125	6,160	4.57
2010	248,598,494	55,397,416	38,888	6,393	4.49
General Education					
2007	\$521,622,993	128,822,947	991,425	\$526	\$4.05
2008	537,657,776	122,425,122	735,184	731	4.39
2009	516,199,309	119,271,738	733,809	703	4.33
2010	504,453,710	115,795,696	702,420	718	4.36

Source: MDE, Report SE-4094; CRC calculations

Where the Money Comes From

Similar to general K-12 education finances, special education funding comes from all three levels of government: federal, state, and local. In each case, resources can come from multiple sources (taxes) and programs (e.g., general operations, specific purposes). Despite some general similarities, special education finance is different than general K-12 finance. For example, federal funding plays a larger role, mainly because of the federal mandates involved in special education. Also note-

worthy, the local share is satisfied both through dedicated property tax revenues (levied at the ISD level) as well as contributions from districts' (local districts and ISDs) general fund budgets. While special education students participate in the per-pupil foundation grant, the total amount of state resources available each year to educate disabled students is based on a fixed percentage of overall costs. When the foundation grant is insufficient to meet the state's obligation, separate categorical funding is provided.

Strengths and Weaknesses of a Cost Reimbursement Model

Special education finance systems vary across the different states and each model has its own unique set of advantages and disadvantages. Further, each advantage and disadvantage will have a different priority depending on the constituency involved. Research has enumerated and classified the strengths and weaknesses associated with the different financing models.*

Michigan is one of five states to employ a percentage reimbursement system as the primary mechanism to distribute state aid for special education programs and services.** While the cost reimbursement system arising out of the *Durant* case supplies the majority of state funding, other smaller state resource streams flow to districts to finance special education. Under cost reimbursement systems, states allocate dollars based on actual expenditures and reimbursement is made for allowable costs that are defined, reviewed and approved by the state. Reimbursement models are least likely to create incentives to misclassify students by their specific disability because classification does not determine the amount of funding received. Additionally, these models do not provide an incentive to place students in a specific educational setting (general versus special education).

Commonly identified weaknesses of these models include the inability of the state government to control costs. This is especially true in Michigan's case where state government is required to meet specific percentages of special education program and transportation costs. Reimbursement is not capped by a state appropriation. Unlike a block grant that might control the state's overall financial exposure, Michigan's state aid system operates more like an entitlement program. Another weakness relates to the administration of such systems as they tend to be heavily rule and report-laden and require vigilant updating. Also, these models are criticized because funding is not linked to student outcomes; a common criticism of all education financing systems (general and special education).

Michigan's state aid system has its foundations in the state Constitution. Changing it will require a constitutional amendment either legislatively-initiated or citizen-led. Alternatively, changes to the state funding mechanism could be addressed during a general review of the constitution via a constitutional convention. The next state-wide vote on the question of calling a convention is November 2026.

* Thomas Parrish, Jennifer Harr, Jennifer Anthony, Amy Merickel, and Phil Esra. "State Special Education Finance Systems, 1999-2000." Center for Special Education Finance, American Institutes for Research. May 2003.

** Eileen Ahearn, Ph.D. "Financing Special Education: State Funding Formulas." National Association of State Directors of Special Education. April 2010.

The *Durant* Decision

Since FY1998, the State of Michigan's funding responsibility for special education services delivered by local and intermediate school districts has been governed by the Michigan Supreme Court's decision in *Durant, et al v State of Michigan, et al*. After 17 years in the courts, in 1997 the Court found that special education programs are a state mandate and that the state had failed to finance its share as required by the "Headlee Amendment" to the 1963 Michigan Constitution. In terms of the mechanics of special education financing, the *Durant* decision is significant for: 1) establishing the specific finance system

used by the State of Michigan; and 2) establishing the funding floor (expressed as a percentage of necessary costs) that the state must meet annually to meet its constitutional obligations. Additionally, the decision prompted major changes to the structure of the State School Aid Act in order to implement the financing system and meet the state's constitutional responsibilities.

The *Durant* decision established a *percentage reimbursement system* as the state's primary special education financing mechanism. Under a percentage or cost reimbursement model, the amount of state special education aid a district receives is tied directly to the expenditures

The *Durant* Decision and the Headlee Amendment: Establishing State Responsibility for Special Education

At the November 1978 general election, voters approved a far-reaching amendment to the 1963 Michigan Constitution commonly referred to as the Headlee Amendment (named after Richard Headlee, the chief architect of the amendment). The amendment changed Section 6, Article IX of the Constitution and added ten new sections (25 to 34) to Article IX. Designed primarily as a tax limitation device, one new provision (Section 29 of Article IX) obligated the state to pay in future years the same proportion of costs for activities or services required of units of local government as the state paid in the year in which the amendment took effect. Section 29 was designed to deter the state from side-stepping the new tax limitations contained elsewhere in the amendment by shifting state costs to local governments.

In 1980, a number of school districts and taxpayers filed suit alleging that the state had violated Section 29 as it related to a number of elementary and secondary education services. This original suit became known as *Durant*, named after Donald Durant, one of the plaintiffs. (The *Durant* name was later used to refer to similar suits filed in 1998 and 2002 on similar grounds.) Through the legal proceedings that followed, the courts narrowed the original complaint specifically to special education programs required by the State of Michigan, as opposed to elementary and secondary education more generally.

On July 31, 1997, 17 years after the original suit was filed, the Michigan Supreme Court held that special education programs are a state mandate and that the state had failed to fund the programs at the amount required by Section 29. The Court's *Durant* ruling included a monetary remedy (\$212 million) to plaintiff school districts resulting from the state's failure to fully fund its costs in FY1992 through FY1994. Non-plaintiff districts participated in a separate \$636 million settlement with the State of Michigan, bringing the total monetary remedy to \$848 million.

Perhaps most importantly, the Court decision also addressed the state's financial obligation for special education prospectively. The ruling established a minimum funding floor that the state is required to meet. Specifically, the Court determined that the Section 29 funding percentages for special education operating costs and special education transportation to be 28.6138 percent and 70.4165 percent of necessary costs, respectively. These percentages represented the state's financial obligations for special education in 1978, when the Headlee Amendment was adopted. As a result of *Durant*, local schools are constitutionally guaranteed that the state will pick up approximately 29 percent of special education program costs and 70 percent of transportation costs each year.

Since 1998, the *Durant* decision has been the single most important factor that determines the State of Michigan's participation in funding special education. These fixed percentages do not change from year to year and they are unaffected by the fiscal condition of the state budget. Changing the state's special education finance system to escape the current financial obligations would require a constitutional change.

incurred. Reimbursement maybe based on 100 percent of costs or some fraction of the costs. Under *Durant*, separate reimbursement rates were established for program and transportation costs. In most cases, costs are determined to be allowable or not allowable for reimbursement and there may be caps on the number of students eligible to be claimed for reimbursement.¹⁴ The Michigan Department of Education annually determines which costs (direct and transportation) are eligible for state reimbursement under the State School Aid Act.¹⁵ Similar criteria are used to reimburse costs with federal pass through dollars provided under IDEA.

In addition to the type of system, the *Durant* opinion established the minimum reimbursement rate; the state government is responsible for just under 29 percent of the approved special education costs and 70 percent of special education transportation costs. This was determined based on the amount of special education costs that the state covered in 1978, when the Headlee Amendment to the Michigan Constitution was adopted.

The state meets its required share of special education costs through financial resources annually allocated to school districts via the State School Aid Act. The Act was reconfigured in the wake of *Durant* with respect to how state government paid for special education students under the foundation program and financed special education costs. In order to comply with the Supreme Court's decision and meet the required minimum funding responsibility, state resources are now distributed through a per-pupil formula as well as on a categorical basis. After *Durant*, districts receive state funding through the foundation program based on the number of special education students first. If the foundation dollars are sufficient to meet the constitutional minimum, no further payment is made. However, if the foundation payment does not represent at least 29 percent of special education costs and 70 percent of transportation costs, combined, then an additional categorical payment is made to meet these thresholds. Prior to the *Durant* decision, state funding for special education was exclusively a categorical payment under the State School Aid Act.

Durant resulted in the state government paying school districts, retroactively, an additional \$844 million for previously unreimbursed special education costs, but it did not directly increase the amount of funding for special

education prospectively (see box). The majority of the changes to the structure of State School Aid Act, which were made to implement the legal decision, largely resulted in state dollars that were previously allocated for unrestricted purposes (i.e., foundation dollars) to be re-directed to restricted special education purposes. Thus, the *Durant* decision's major significance was the establishment of the type of special education state aid system (i.e., percentage reimbursement) as well as determining the state's specific cost sharing responsibility.

State School Aid Act

State funding provided to local and intermediate school districts for special education relies on a complex mix of formulae and payments contained in the State School Aid Act. The state aid calculations for each district (local and intermediate) are largely governed by very specific details contained in the *Durant* decision and the amount of state aid received in FY1997 (the year prior to *Durant*). A district's total state aid received is equal to the sum of funding received through the per-pupil foundation formula and the amounts from various categorical funding; however, the largest source of state operating funds comes from the foundation program.¹⁶

In addition to the type of system, the *Durant* opinion established the minimum reimbursement rate; the state government is responsible for just under 29 percent of the approved special education costs and 70 percent of special education transportation costs.

The foundation program is the primary funding mechanism created by the Proposal A school finance reforms to distribute state aid to districts for both general and special education students. The foundation grant, expressed as an amount per pupil, is set annually by the state during the annual appropriations process. The total revenue a district receives under the foundation program each year is a function of the district's grant amount (which varies by district) and the number of students enrolled each year.

Special education students, like general education students, participate in the per-pupil foundation program with one significant difference; the special education foundation grant is funded entirely from state resources, whereas the general education foundation grant is funded from a combination of state and local revenues. For general education foundation grants, the local dollars (from the 18-mill non-homestead school operating tax) are the first ones used to finance the grants and state aid is used to make up the difference between the guaranteed per-pupil amount and the amount raised locally.

FINANCING SPECIAL EDUCATION: ANALYSES AND CHALLENGES

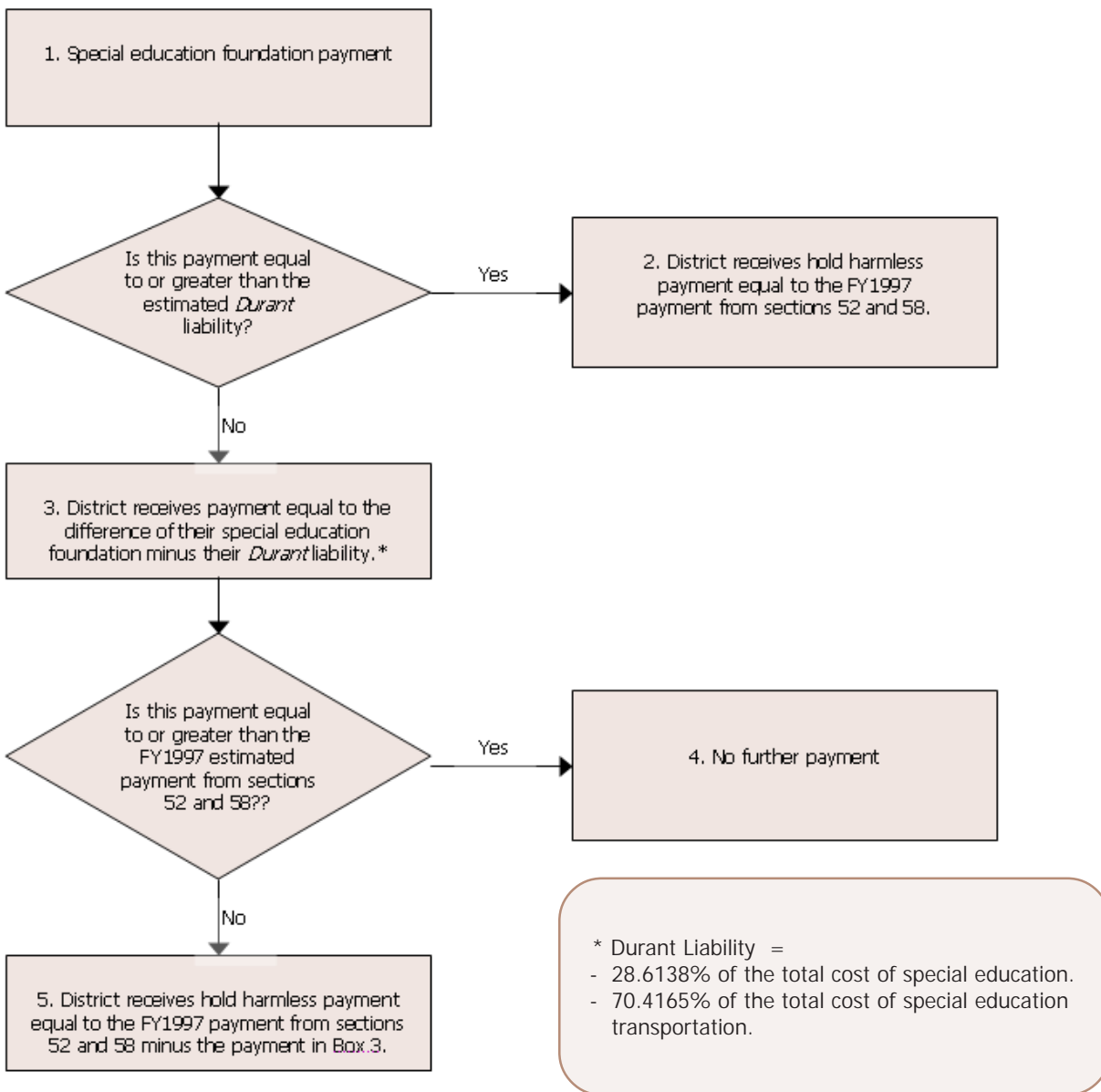
The amount of total foundation revenue that a district receives each year is the product of the district's per-pupil grant (or state maximum grant, whichever is less) and the number of full-time equivalent (FTE) special education students.¹⁷

The foundation dollars are the first ones applied against the state's *Durant* obligation. If a district's total special education foundation revenue meets or exceeds the state's cost share obligation, no further state reimbursement is required. However, if the special education foundation payment does not meet or exceed the sum of the

29 percent reimbursement (special education costs) and 70 percent reimbursement (transportation costs) amounts, a categorical payment is made to the district on a sum sufficient basis. This payment (authorized in section 51a(2) of State School Aid Act) is equal to the difference between what is provided by the foundation program and the amount guaranteed by *Durant*.¹⁸ The interaction between the foundation payment and the state's *Durant* obligation is portrayed in **Illustration 1**.

In some cases, districts receive a "hold harmless" payment. This payment was designed to ensure that no

Illustration 1
Determination of State Aid Amounts



Source: Michigan House Fiscal Agency.

CRC REPORT

district received less money as a result of the *Durant* decision than it received in FY1997 from the state for special education purposes. Thus, if a district received from the state an amount greater than the *Durant* guarantee in FY1997, it continued to do so in FY1998 following the court decision.

A separate categorical grant is also provided to districts that educate certain “low incidence” students described in the State School Aid Act, often referred to as “section 53” students. Generally, these students represent only a small fraction (1.4 percent in 2010) of the total special education FTE in any given year and have been placed in a non-traditional educational setting through a decision made by a state agency or the courts. The state picks up 100 percent of the total approved costs of these students, as opposed to 29 percent for other special education students. The FTE count for “section 53” students is not included in the foundation calculation for other special education students, but rather there is a separate foundation calculation for “section 53” students. The amount of the state categorical payment is equal to the

difference between the “section 53” foundation and the total approved costs for these students in order to reimburse at the 100 percent rate.

Whether a district receives only the foundation grant funding or the foundation dollars and categorical funds, the State School Aid Act is structured such that State of Michigan picks up, at a minimum, 29 percent of special education costs and 70 percent of transportation costs pursuant to *Durant*. Some districts also receive separate special education categorical grants under the Act; however, these payments are not included in the calculations associated with meeting the state’s responsibility under the *Durant* decision and therefore they are excluded from the discussion here.¹⁹

Table 7 shows the history of allowable special education costs, disaggregated, and the state reimbursement provided pursuant to the *Durant* decision. The amount of state reimbursement increased constantly from \$568 million in FY1998 to \$923 million in FY2009, before exhibiting its first decline in FY2010 (attributable, in part,

Table 7
State Reimbursement for Special Education Costs Associated with *Durant*
(Millions of Dollars)

Fiscal Year	Program	State Share*	Transportation	State Share**	Low Incidence Pupils		Total State Reimbursement
	Costs		Costs		Costs	State Share***	
1998	\$1,551.0	\$443.8	\$153.5	\$108.1	\$16.5	\$16.5	\$568.4
1999	1,625.7	465.2	158.0	111.3	18.1	18.1	594.6
2000	1,741.3	498.3	161.3	113.6	18.7	18.7	630.6
2001	1,843.8	527.6	190.5	134.1	18.5	18.5	680.3
2002	1,930.6	552.4	191.5	134.9	17.9	17.9	705.2
2003	2,046.4	585.6	202.6	142.7	18.9	18.9	747.1
2004	2,136.9	611.4	210.0	147.9	18.7	18.7	778.0
2005	2,220.9	635.5	226.1	159.2	20.2	20.2	814.9
2006	2,319.4	663.7	241.4	170.0	19.5	19.5	853.2
2007	2,339.6	669.4	247.2	174.1	20.0	20.0	863.5
2008	2,473.9	707.9	262.1	184.6	21.0	21.0	913.5
2009	2,527.2	723.1	253.4	178.4	21.7	21.7	923.2
2010	2,392.3	684.5	248.6	175.0	19.0	19.0	878.6

Change from FY1998 to FY2010 54.6%

Change in US CPI: FY1998 to FY2010 33.9%

* Reimbursement rate of 28.6138 percent.

** Reimbursement rate of 70.4165 percent.

*** Reimbursement rate of 100 percent for certain “low incidence” pupils.

Source: Michigan Department of Education, Report SE-4096, Report SE-4094

Table 8
ISD Special Education Property Tax for Selected Years

<u>Tax Year</u>	<u>Average Rate (mills)</u>	<u>Tax Yield (\$millions)</u>	<u>Dollar Change</u>	<u>Percent Change</u>	<u>Dollars per Pupil</u>	<u>Dollar Change</u>
2001	2.3978	\$531.3			\$2,346	
2005	2.5137	862.4			2,135	
2007	2.5059	964.3	\$55.3	6.1%	3,873	
2008	2.5418	1,026.2	61.9	6.4%	4,205	\$332
2009	2.5409	1,037.8	11.6	1.1%	4,320	115
2010	2.5621	1,026.7	(11.1)	(1.1%)	4,354	34
2011*	2.5551	956.0	(70.7)	(7.0%)	4,217	(142)

* preliminary

Source: MDE; Department of Treasury; CRC calculations

to the significant amount of federal stimulus dollars that supplanted state and local resources). Over the entire period, total state costs were up 55 percent compared to a 34 percent increase in inflation over the same period. Because of the mechanics of *Durant* (fixed percentage reimbursements), total state costs rose in concert with total costs (direct and transportation combined).

ISD Special Education Property Tax

Special education finances were not affected by the school finance reforms of the mid-1990s in the same way that the reforms affected general education finances. While state revenue sources assumed the majority role in general education following the adoption of Proposal A in 1994, local property taxes continued to play the major role in the overall special education financing system, just as they did prior to reform. Also, local communities continued to determine the total amount of money available because they retained access to dedicated special education millage authority (with newly established caps). Although these millages are levied by intermediate school districts (ISDs), the proceeds are shared among local constituent districts and the parent ISD to deliver special education programs and services based on the agreed upon special education plan. The tax rates and bases of the ISD millages vary, accounting for the differences in the amount of revenue raised in total and on a per-pupil basis.

As part of the Proposal A reforms, state law imposed a cap on each ISD's special education millage rate. The rate cap was established at 1.75 times the number of special education mills levied in 1993. In order for a

district to increase its millage rate above the rate levied in 1993, it must get voter approval.

The special education property tax is subject to the automatic rate "rollback" provisions of Michigan Constitution's Headlee Amendment (Article IX, Section 31). For this reason, many districts levy the tax at a rate below the maximum amount currently authorized. Previous rate "rollbacks" only can be reversed with voter approval. The proceeds from the tax must be used for special education operations and are subject to state review.

In 2010, all 57 districts levied a dedicated special education property tax. The lowest tax rate was 0.6371 mills (Iosco Regional Education Services Agency (RESA)) and the highest rate was 5.6264 mills (Jackson ISD). One mill is equal to \$1 of tax for every \$1,000 of taxable value. The statewide average tax rate was 2.5621 mills. Statewide, the tax yielded just over \$1.0 billion, almost 40 percent of the total \$2.7 billion in state approved costs (including transportation but excluding federal expenditures).

Growth in the special education property tax yield statewide has been significant, nearly doubling between 2001 (\$531 million) and 2010 (\$1,027 million) (See **Table 8**). Scaling the aggregate amount on a per-pupil basis shows similar strong growth. On a statewide basis, per-pupil property tax revenue increased from \$2,346 in 2001 to \$4,354 in 2010 (86 percent increase). The growth in aggregate and per-pupil revenues resulted from tax rate increases, as well as expansion of the tax base.

The statewide average property tax rate rose from 2.3978 mills in 2001 to 2.5621 mills in 2010, with most of the increase occurring between 2001 and 2005 (2.5137 mills). The increase in the statewide average tax rate is evidence that ISDs, often with the support of their local constituent districts, have lobbied and gained local approval to increase rates above the levels previously authorized (see box on page 25). In a few cases, the rate increases moved districts very close to their statutory cap (1.75 times the 1993 rate), while in most other instances districts did not pursue authorization to raise the rate to the maximum allowed.

Expansion of the tax base also contributed to revenue growth. Statewide, the tax base increased 50 percent from 2001 to 2010. Annual increases in the tax base were strong (above 5 percent per year) throughout the early 2000s and continued until late in the decade; however, the annual growth rate moderated with the Great Recession and the slowdown in the housing market.

Statewide total taxable value declined marginally in 2009, the first time since Proposal A (when taxable value was

introduced as the measure of the tax base). Larger declines occurred in 2010 and 2011, indicating that this traditionally stable revenue source has created challenges for special education finances in recent years as the tax yield has declined. Looking at ISD tax bases in 2007 and 2011 reveals the effects that the Great Recession and the housing market bubble bursting have had on property tax receipts in recent years and the challenges posed to some specific ISDs. A number of districts are expected to see further tax base reductions in 2012 and beyond. Many of the larger ISDs, which also make up a large portion of the overall tax base, have been significantly affected (**Table 9**) by the recent erosion in their tax bases, while the vast majority of ISDs did not see any reduction in their tax bases between 2007 and 2011.

In 2010, the amounts raised from the dedicated ISD property tax ranged from just over \$1 million in some smaller, rural ISDs (Iosco RESA and Sanilac ISD) to \$169 million in the state's largest ISD (Wayne County RESA). Aggregate yields, however, reveal very little about the amount of resources available to educate and provide services to individuals in local communities. Scaling these revenues

Table 9
ISD Tax Base Changes: 2007 to 2011
(Dollars in Billions)

ISD	2007 Taxable Value	Percent of Statewide Tax Base	2011 Taxable Value	Percent of Statewide Tax Base	Change 2007 to 2011
Oakland Schools	\$61.7	18%	\$54.3	16%	-12.1%
Genesee ISD	11.9	4%	10.6	3%	-11.0%
Wayne RESA	50.7	15%	45.1	14%	-10.9%
Macomb ISD	30.9	9%	28.2	9%	-8.7%
Midland County ESA	3.4	1%	3.2	1%	-6.8%
Livingston ESA	7.3	2%	7.0	2%	-5.1%
Lapeer ISD	2.6	1%	2.5	1%	-5.0%
St. Clair County RESA	5.8	2%	5.5	2%	-4.0%
Monroe ISD	5.6	2%	5.5	2%	-2.0%
Washtenaw ISD	14.3	4%	14.1	4%	-1.3%
Subtotal	\$194.3	58%	\$176.1	54%	-9.4%
Remainder of ISDs	\$143.9	42%	\$154.6	46%	7.4%
Statewide	\$338.2		\$330.7		-2.2%

Large ISDs Raised Rates in 2000s

A good portion of the statewide tax yield increase from 2001 to 2010 can be explained by rate increases in a handful of large ISDs. Combined, these ISDs educate a large portion of the special education population and account for much of the property tax revenue generated (See **Table 10**). The six ISDs identified below accounted for 50 percent of the total property tax revenue in 2001; however, after substantial rate increases in each district during the last decade, their collective share of the total rose to 60 percent. Other smaller ISDs also increased rates during this period. Overall, 17 of the 57 districts increased their tax rates between 2001 and 2010; however, 10 districts (including the six large districts) raised their rates by greater than 25 percent. All others (except one district) raised their rates by less than 10 percent. Wayne and Oakland, the two largest districts, raised their rates by 79 percent and 75 percent, respectively.

Table 10
Special Education Property Tax Rates in Select ISDs: 2001 and 2010

<u>ISD (# of pupils)</u>	<u>2001 Tax Rate (mills)</u>	<u>Share of Total Statewide 2001 Revenue</u>	<u>2010 Tax Rate (mills)</u>	<u>Share of Total Statewide 2010 Revenue</u>
Kent (14,580)	2.7475	8%	3.7099	8%
Macomb (18,873)	1.8125	7%	2.7407	8%
Oakland (23,751)	1.4527	12%	2.5456	15%
Ottawa (6,078)	3.1265	4%	4.3750	5%
Washtenaw (6,791)	3.0277	5%	3.8761	6%
Wayne (43,873)	1.8815	13%	3.3678	17%
State (227,500)	2.3978		2.5137	

Source: Michigan Department of Treasury; CEPI; CRC calculations

The timing and stated reasons for the rate increases across the ISDs varied. Rising populations and special education costs contributed to some of the justification for the rate hikes. Other increases likely financed new services and programs offered by the ISDs and/or local districts. It is also likely that districts sought the additional property tax revenues to relieve the general fund budget pressures that ISDs and local districts faced from the escalating special education costs. General fund pressures became more pronounced as the decade progressed and as annual increases to the per-pupil foundation grant decreased or disappeared altogether.

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to account for the number of special education students provides context to the range of total revenue generated from the tax.

Looking at the per-pupil amounts generated from this tax reveals a sizeable range (See **Table 11**). The lowest per-pupil amount was \$1,082 (Sanilac ISD), but the highest amount was nearly eight times greater at \$8,532 per

pupil (Washtenaw ISD). The statewide average was \$4,354 per pupil.

Not surprisingly, districts at the top of the range tended to have higher tax rates while those at the bottom had lower tax rates (statewide average rate was 2.5621 mills). Those at the top also benefited from above average property wealth (taxable value per special education student). One of the top five districts (Charlevoix-Emmet at \$7,171

Table 11
Special Education Property Tax Revenue in 2010

<u>ISD</u>	<u>Tax Revenue</u>	<u>Special Education Pupils</u>	<u>Per-Pupil Revenue</u>	<u>Tax Rate (mills)</u>	<u>Taxable Value Per Pupil*</u>
Five Highest Per-Pupil Amounts					
Washtenaw	\$57,942,247	6,791	\$8,532	3.8761	\$317,920
Ottawa	49,805,239	6,078	8,194	4.3750	241,658
Huron	5,495,463	766	7,174	3.2886	350,579
Charlevoix-Emmet	10,032,765	1,399	7,171	1.8313	544,485
Oakland	157,503,945	23,751	6,631	2.5456	314,186
Five Lowest Per-Pupil Amounts					
Sanilac	\$1,079,084	997	\$1,082	0.7298	\$202,044
Lapeer	2,219,587	1,795	1,237	0.8310	190,289
Iosco	1,025,456	791	1,296	0.6371	355,467
Eastern UP	1,645,724	1,245	1,322	0.7727	277,182
Midland	3,177,171	2,228	1,426	0.9797	243,621
State Average			\$4,354	2.5621	\$223,778

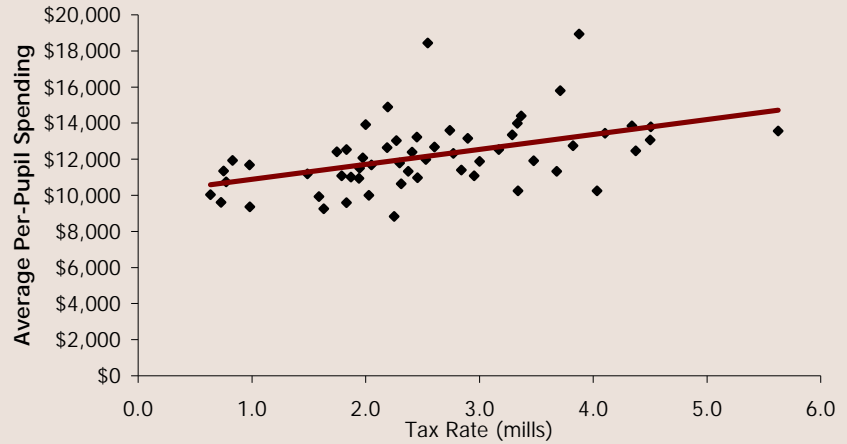
* Includes general and special education students.

Source: MDE; Department of Treasury; CRC calculations

per pupil) had a below average tax rate but a very wealthy tax base on which to levy the tax. Three of the five districts with the lowest per-pupil revenue had below average property wealth in addition to lower tax rates.

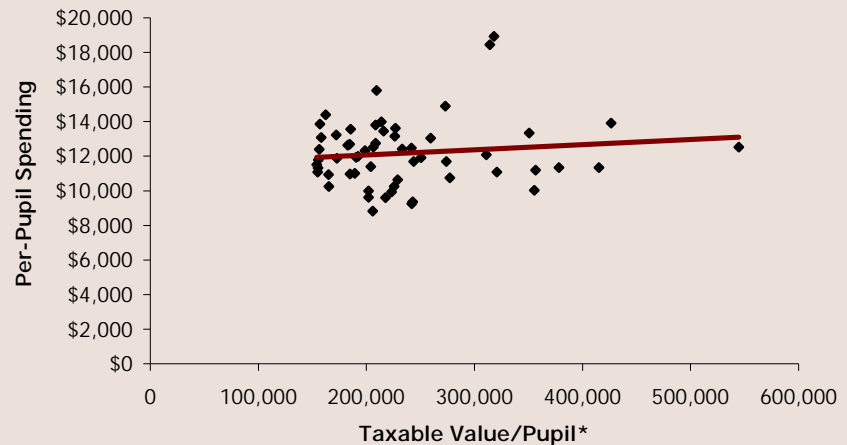
Differences in average per-pupil spending across ISDs are explained, to a large degree, by the amount of per-pupil tax revenue generated by the special education millage. Districts with access to substantial property wealth (taxable value per pupil) can raise relatively more money than those in less wealthy communities. Similarly, those that tax at higher rates (all else constant) can generate more resources. The relationships between the two components of

Chart 7
Per-Pupil Spending and ISD Property Tax Rates in 2010



Source: MDE; Michigan Department of Treasury; CRC calculations

Chart 8
Per-Pupil Spending and ISD Property Tax Bases in 2010



* includes both general and special education students

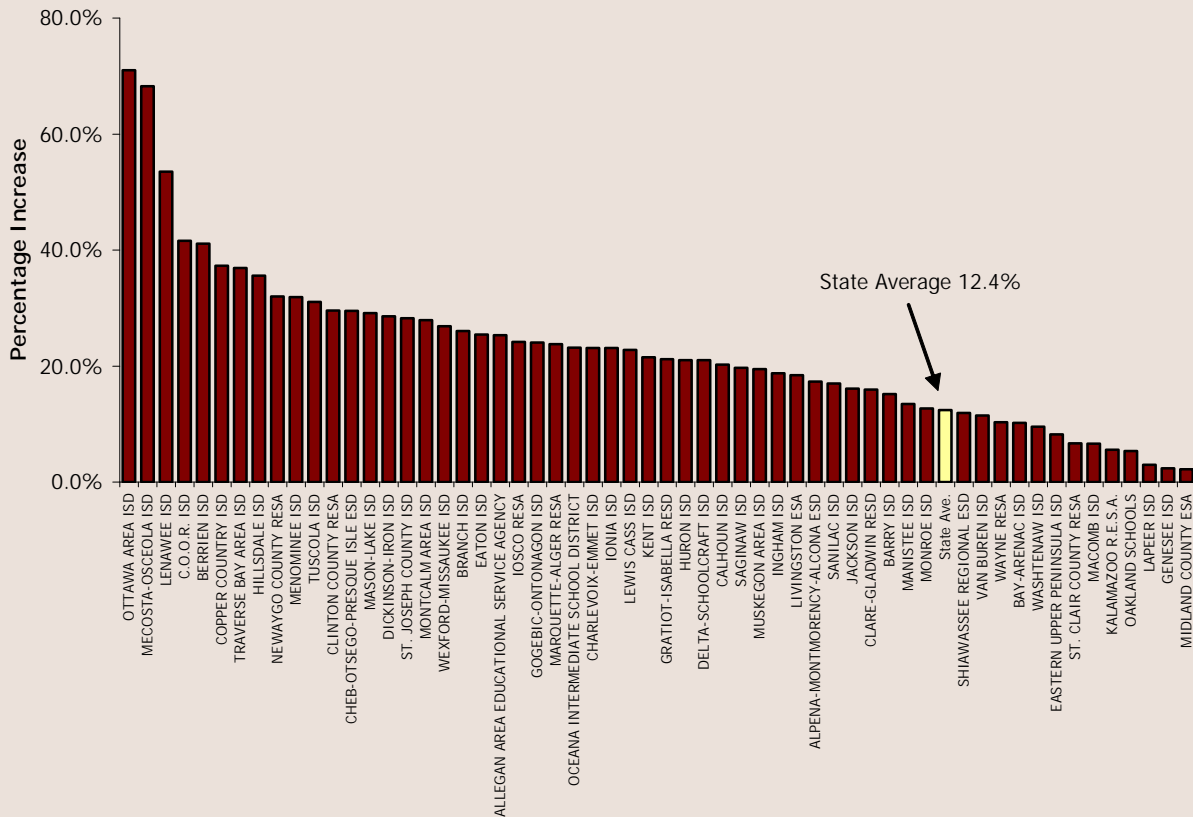
the local tax (rate and base) and the average per-pupil spending in each ISD are shown in **Charts 7 and 8**. Of course, other factors contribute to the spending variation observed among ISDs, as discussed earlier.

At the individual ISD level, changes in the tax yield over the most recent period showed considerable variation resulting from changes in the tax base (growth or decline) and tax rates at the local level. Whereas the statewide average per-pupil tax yield increased 12.4 percent between 2007 and 2010 (from \$3,873 to \$4,354), the experiences of ISDs ranged from an increase of 2.2 percent (Midland County ESA) to 71 percent (Ottawa Area ISD). **Chart 9** shows this variation. Similar to the picture of total per-pupil spending (displayed earlier in **Chart 4**), the statewide average is much closer to one end of

the range (lower end in this case) as opposed to the median value (23 percent) because many of the larger ISDs had smaller tax yield increases between 2007 and 2010, thereby pulling down the statewide average.

Although the tax is levied at the ISD level, the proceeds are shared with constituent districts (traditional public and charter schools), where many of the services and programs are provided. State law does not require ISDs to use a specific method to distribute the special education tax proceeds among service providers. Therefore, a few different methods are used across the state. However, state rules require that the method used by an ISD must be designated in its special education plan, which must be approved by all constituent districts. Also, the rules prohibit distribution methods based on the amount

Chart 9
Per-Pupil ISD Property Tax Yield Change: 2007 to 2010



Source: MDE; Michigan Department of Treasury; CRC calculations

ISD Millage Equalization Payments

The state has recognized the effects that property wealth disparities can have on the ISD tax levy and how it contributes to per-pupil spending inequities. To address this issue, the state created a categorical payment program (\$37 million in FY2010). The State School Aid Act provides eligible ISDs with a “millage equalization” payment to augment the revenue that is generated from the ISD special education tax. Each year the state determines the level (expressed as taxable value per student membership (includes general and special education students)) at which the special education tax millage will be equalized. For taxes levied in 2010, the state equalized special education millages in districts where the taxable value per pupil was \$179,700 or less, which was below the average taxable value per pupil for the year (\$223,778). Thus, ISDs with property wealth below the predetermined amount had their tax base equalized up to the specified amount. The state payment was equal to the difference between the ISD millage yield and the amount that would have been generated if the tax was levied on the tax base set by the state. Equalization payments were provided to 17 of 57 districts in 2010.

of tax generated. In other words, plans cannot guarantee that individual districts will receive the same amount of tax revenue to deliver services that is generated from the tax in their community. Therefore, distribution methods tend to have a redistributive property.

While not required, the default distribution method employed by many ISDs is the “added cost model”. Under the added cost model, funds are distributed to districts based on their “added costs”; the difference between a district’s total approved costs and the state aid received. If the tax revenue generated is insufficient to reimburse all districts for the full amount of their “added costs”, then prorated payments are made. However, before proration occurs, the funds may be used to finance 100 percent of the costs of services and programs operated by

the ISD or constituent districts that are available to all districts; these are often called center-based programs. In effect, center-based programs receive an “off the top” allocation of the ISD tax levy before any distribution to constituent districts occurs.

Some ISDs, such as Ingham, have moved away from the added cost model because of the unintended consequences associated with it (see box below). One popular alternative is a hybrid or “average cost” model. Similar to the added cost method, the hybrid method distributes the ISD tax proceeds after state aid allocations are made to districts; however, this model relies on the county average cost of special education services and programs and the number of students in each district rather than the total special education costs incurred

Common Criticisms of the Added Cost Model

The added cost model can result in different levels of reimbursement for the same total special education expense. Also, because of the reimbursement nature of this model, there are no cost containment incentives. Higher expenses in one district generate additional reimbursement; thereby reducing the amount of the tax available for other districts. These characteristics of the model are evident in the following example, which uses two hypothetical districts (See **Illustration 2**).

Illustration 2 Hypothetical Added Cost Model for Distributing ISD Tax Revenue

	<u>District A</u>	<u>District B</u>	<u>Total</u>
Total Costs (assumes \$10,000 per student)	\$100,000	\$100,000	\$200,000
Less: State Aid (\$7,000 per Special Education FTE)	(21,000)	(42,000)	(63,000)
Equals: "Added Cost"	79,000	58,000	137,000
ISD Tax Distribution (\$50,000 available)			
Proration (percent of total "added cost")	\$79/\$137K=58%	\$58K/\$137K=42%	
Payment (proration percent * tax available)	\$29,000	\$21,000	\$50,000
Assumptions:			
Total Special Education students (head count)	10	10	
Special Education FTE/General Education FTE	3/7	6/4	

In this example, the two districts have the same number of special education students (10 students) and the same total special education costs (\$100,000). However, the educational setting placement of the students (general vs. special education) varies, which accounts for the differences in state foundation reimbursement and therefore the "added cost" calculations. District A has a higher reimbursement rate than District B, despite the fact that more students (FTEs) are special education settings in District B. Although not presented here, District A could increase its reimbursement rate even further if its total costs were greater than District B; there is a perverse incentive to control costs.

in the district to allocate the local tax revenue. As result, a district is not rewarded directly for increasing its total costs and has no incentive to do so. Under this model, safeguards are employed to ensure that districts are not able to receive reimbursement (in combination with their state aid) that would exceed their costs.

Federal IDEA Funds

Dating back to its origins in the mid 1970s, the Individuals with Disabilities Education Act (IDEA) has provided states with grants to meet the federal mandate to provide a free appropriate public education to all students with disabilities. Currently, states receive funds through three regular, ongoing grants and they are eligible for a number of discretionary grants. The largest ongoing source of funding is provided under Part B (Section 611) of the Act and is designated for K-12 students (ages 3

through 21). Smaller amounts are distributed for state preschool programs (also under Part B, Section 619) and under Part C for infant and toddler state grants to fund pre-K and early intervention services (from birth to age three). These funds are distributed to states by formula. In Federal Fiscal Year 2010 (FFY2010), total IDEA funding was \$12.3 billion, of which \$11.5 billion (94 percent) was dedicated to Part B state grants (same amount as FFY2009).

Since the early 1990s, states have been eligible to receive funding through the Medicaid program to provide health care services to students with disabilities. Today, Michigan receives formula allocations under IDEA as well as Medicaid funds to finance services. A key difference between these two programs is that the former is a discretionary grant (subject to appropriation), while the latter is an entitlement program.

When the U.S. Congress passed IDEA in 1975, it committed to funding up to 40 percent of the Average Per-Pupil Expenditure (APPE) in public elementary and secondary education for every disabled student, an amount known as “full funding”.²⁰ Prior to IDEA’s reauthorization in 2004, Congress had never authorized full funding and the 40 percent threshold was never attained. When IDEA was reauthorized in 2004, funding levels through FFY2011 were set. Although IDEA increased the federal authorizations each year until they reached approximately the 40 percent commitment in the final year (FFY2011), actual appropriations always fell well short of the authorized amount. (Generally speaking, authorized amounts represent the maximum amount that appropriators can provide for a program in a given year. Congress must annually appropriate funding, but rarely do appropriations in any given year equal the authorized amount.) During its existence, and prior to the stimulus funding in 2009, federal appropriations for IDEA had never decreased from one year to the next.

Under the 2004 version of IDEA, the federal government’s authorization was significantly higher than the amount appropriated each year from FFY2005 through FFY2011. In fact, according to the Federal Funds Information for the States, in FFY2005 the full funding amount was \$23 billion, but the authorized amount was \$12.4 billion and the appropriated amount was \$10.6 billion. For FFY2005 and FFY2007, appropriated amounts fell more than 50 percent below full funding.²¹ Michigan’s actual allocation in FFY2007 (\$376 million) was \$453 million less than the full funding amount for FFY2005 and \$214 million less than the amount authorized under IDEA for the year. For FFY2008, the most recent data available, IDEA covered just 17.1 percent of the estimated excess cost of educating children with disabilities, the same as it did in FY2007 and less than it did in FY2006 when federal funding covered 17.7 percent of the cost.²²

IDEA Part B, Section 611 funds are distributed to states through a complex formula where each state is guaranteed base funding equal to what it received in FFY1999. The remainder is distributed to states based on their relative share of children within the age range served by IDEA and their relative share of children in that age range living in poverty. Allocations to states are based on head count data. (Michigan uses FTE data to distribute state

aid through the foundation grant program.) Several other complicating factors also can come into play.

Michigan’s FFY2010 IDEA award totaled nearly \$400 million, the majority of which (\$355 million) was shared with the 57 ISDs under Part B, Section 611 of the Act. The Michigan Department of Education retains a portion of the state’s total allocation for administration and other statewide activities (permitted under federal guidelines). Sub-state allocations are based on three-part formula involving a base allocation (75 percent of each ISD’s FY1999 award) and two per-pupil amounts.²³ The ISDs vary in terms of the amount and method used to distribute IDEA funds to local constituent districts. These guidelines are spelled out in ISD special education plans, which also address how local property taxes are, along with the method used.

Michigan established the School Based Services (SBS) program in 1993 to allow districts to receive partial reimbursement for services provided to students with special needs under IDEA (Parts B and C). All 57 ISDs and the City of Detroit Public School District are enrolled in the Medicaid program as providers under the SBS.

Medicaid Funds

Medicaid is a jointly financed federal-state health insurance program for persons with low income and/or disabilities authorized under Title XIX of the federal Social Security Act. Title XIX was amended in 1988 to provide reimbursement of certain health care and related services provided by schools for individuals enrolled in the Medicaid program. Michigan established the School Based Services (SBS) program in 1993 to allow districts to receive partial reimbursement for services provided to students with special needs under IDEA (Parts B and C). All 57 ISDs and the City of Detroit Public School District are enrolled in the Medicaid program as providers under the SBS.

Medicaid reimbursement provided to school districts under the SBS works differently than it does for other Medicaid service providers (doctors, nursing homes, HMOs, etc.). Under the SBS program, districts receive a portion of the federal reimbursement for the costs incurred for eligible services. As public bodies, the non-federal portion of Medicaid-eligible expenditures is assumed to have been made through other avenues (state aid, local property taxes, etc.). The amount of federal reimbursement provided to districts is reduced by 40 percent and these funds are retained by the State of Michigan to help offset state General Fund expenditures in the Medicaid program. Thus, districts receive 60 percent of the federal financial participation. (The state’s federal reimburse-

Stimulus Funding: A Temporary Federal Windfall

The American Recovery and Reinvestment Act of 2009 (ARRA) provided states with temporary federal funds to help them maintain budget balance, avoid public program and service reductions, and mitigate reductions in public employment that accompanied the national recession that spanned 18 months (2007 through 2009). Federal funds were distributed for a variety of purposes, including public education, and were available for expenditure through 2011 in most cases. Michigan received resources for general K-12 education purposes as well as special education programs delivered through IDEA, Part B.

The special education IDEA dollars were distributed to states based on 2008 pupil counts and made available beginning in February 2009. These resources had to be spent by September 2011. Federal provisions directed the one-time ARRA funding to be used for capacity-building activities, including teacher improvement and training, technology, and systemic improvements.* Although not prohibited from doing so, states and local districts were strongly encouraged to avoid using recovery funding for ongoing costs, such as supporting personnel costs that could not be sustained when the federal monies expired.

The stimulus legislation provided an additional \$12.2 billion through IDEA, essentially doubling the amount provided in 2009 (\$11.3 billion of the total was dedicated to Part B for school aged students). Even with these dollars, total IDEA funding in 2009 fell short of the full funding promise (40 percent of costs), although it raised the federal share from about 17 percent to nearly 34 percent of the total.

The one-time ARRA funds had a significant effect on Michigan's IDEA award in FFY2010. The state received just over \$400 million, which was allocated to ISDs based on student counts. This money was available in state FY2009 through FY2011; however, the majority of the resources were spent in state FY2010. This compares to about \$355 million in ongoing IDEA Part B funding the state received in FFY2010.

State special education finances also benefited from ARRA provisions that increased states' FMAPs to help them with Medicaid finances during the economic recession. Enhanced matching funds were included in ARRA, effectively raising all FMAPs by 6.2 percentage points from October 2009 through December 2010. Smaller increases were authorized when the original increase expired (3.2 percentage points from January to March 2011; 1.2 percentage points from April to June 2011). States hit hardest by the recession were eligible for additional rate enhancements. Largely because of ARRA, Michigan's FMAP jumped from 58 percent in FY2008 (pre-ARRA) to 71 percent in FY2009 (partial year ARRA enhancement) and 73 percent during FY2010 (full year ARRA enhancement). Its post-ARRA rate in FY2012 is 66 percent.**

All participants in the SBS program benefited from the enhanced federal matching rate during the time that ARRA was in effect. However, similar to the one-time nature of the stimulus funds provided through IDEA, the increased FMAPs were temporary. Also, because of the relatively minor role played by Medicaid, the enhanced rates likely did not substantially improve special education finances. Districts were encouraged to use the IDEA money for capacity building as opposed to hiring personnel that could not be sustained once the funding expires. The enhanced FMAP rates provided some budgetary relief for school-based health services; however, beginning in 2012, budgets will have to accommodate the regular federal matching rates and service levels may have to be recalibrated to align with available resources.

* Michigan Department of Education, Office of Special Education and Early Intervention Services. American Recovery and Reinvestment Act of 2009 (presentation). March 19, 2009.

** US Department of Health and Human Services, Assistant Secretary for Planning and Evaluation. Federal Medical Assistance Percentages.

ment is called the Federal Medical Assistance Percentage or FMAP, which can change annually with a formula that compares state personal income with U.S. personal income. In 2012, Michigan's FMAP is about 66 percent. For example, for every \$1 spent in the program the federal government covers \$0.66 and non-federal (state) resources pick up \$0.34.)

As an example of how the SBS reimbursement works, consider eligible Medicaid services totaling \$100. In this case, the ISD would be eligible for \$39.60 in reimbursement from the federal government, as opposed to \$66 based solely on the state's FMAP. The ISD reimbursement is calculated in the following way: \$100 (eligible services) * 66% (FMAP) = \$66 (total state reimbursement); \$66 * 60% (ISD share) = \$39.60 (total ISD reimbursement). Stated another way, the effective ISD reimbursement rate in 2012 is approximately 40 percent of total costs. Of the \$100 in Medicaid claims, the remaining \$26.40 in reimbursement made to the state (\$66 - \$39.60 = \$26.40) is retained by the state's Medicaid program to support expenditures that otherwise might be financed with state General Fund dollars.

The SBS program includes two components: 1) Fee-For-Service (FFS) reimburses districts for direct health services to special education students; and 2) Administrative Outreach reimburses districts for providing information about Medicaid to families and helping locate, identify, and refer qualifying children and their families for Medicaid services. The FFS component began in 1993, while the latter piece commenced in 1996. Districts are reimbursed based on an annual cost report submitted to the federal government (through the state Medicaid agency) that lists actual total Medicaid-related costs (combined ISD and local district).

For FY2010 (most recent data), eligible expenses totaled \$321 million statewide. Because of the effect of the 2009 federal stimulus law on Michigan's FMAP (see box on page 36), the federal government will pick up a larger percentage of the total costs in FY2010 than it normally would have. With the increased FMAP rate, the federal reimbursement averaged almost 73 percent (\$234 million). When the FMAP increases, the SBS reimbursement also increases. As of mid-January 2012, final settlement for all schools had not been completed and actual reimbursements made to schools totaled \$118 million for FY2010.²⁴ Based on the total eligible cost figure, the maximum amount that local schools will be eligible to

receive is \$140 million (60 percent of the federal reimbursement). Per the historical state/local split, the state Medicaid agency will be eligible for the remaining 40 percent of the federal reimbursement (\$94 million).

Although ISDs receive only 40 percent reimbursement for Medicaid services, these funds played an important role in defraying rising costs over the last 17 years. Despite the fact that the SBS reimbursement process is complex and record keeping/reporting is quite extensive (major changes occurred in mid-2008 to meet federal requirements), school officials generally report that the benefits outweigh the challenges with the program.²⁵ Overall, this funding source plays a relatively small role in special education financing (generally less than 5 percent). However, some districts with larger Medicaid-eligible populations rely more heavily on these resources to support services.

The General Fund Subsidy

Michigan's special education funding system is structured in such a way that general fund budgets (primarily those of local constituent districts, but also ISDs) serve as the "funders of last resort" when it comes to financing special education services. When the costs of mandated programs and services exceed the amount of dedicated special education revenues from all sources combined (federal, state, and local), districts' general fund dollars must make up the difference.

This is not a new phenomenon as general fund budgets have effectively subsidized special education for some time because combined dedicated revenues (federal, state, and local) have never fully covered all costs for many districts. In some cases, the amount of dedicated resources has never approached the level initially pledged. For example, dating back nearly 40 years, the federal government has never met its promise to provide full funding (defined as 40 percent of the added costs) and currently only meets about half of its original commitment. Similarly, since the late 1990s, the State of Michigan has been responsible for a fixed percent of program costs (about 28 percent as a result of the *Durant* decision). After accounting for state and federal earmarked revenues, local revenues (dedicated and general fund) are responsible for making up the difference (over 50 percent excluding transportation services). When dedicated special education property tax revenues are insuf-

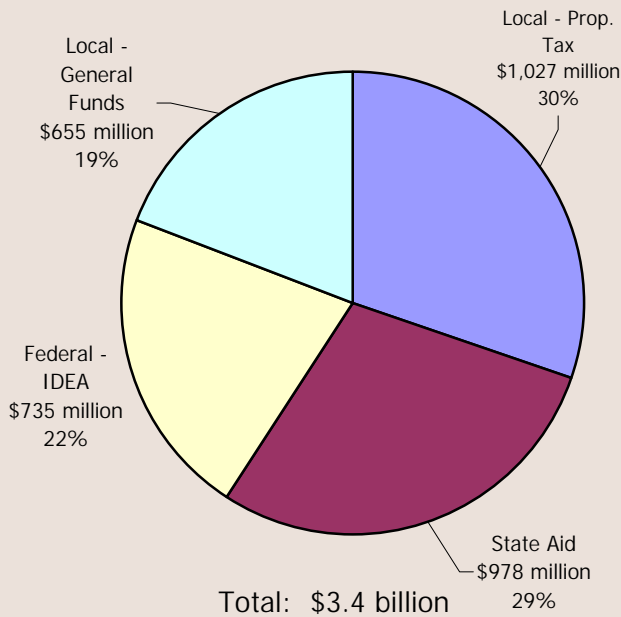
efficient to meet the remaining local share, local schools and ISDs have no place to turn but their general fund budgets. This general fund contribution effectively “tops off” what is provided through earmarked sources.

The amount of general fund resources supporting special education can be examined in total and at a sub-state level. **Chart 10** shows the percentage and amount of revenue from each major funding source supporting the nearly \$3.4 billion of reported costs statewide in FY2010.²⁶ For the entire state, the general fund subsidy amounted to 19 percent, or \$655 million, of total costs. This was the smallest piece of the total funding; just

below the amount of federal IDEA funding (22 percent of total).

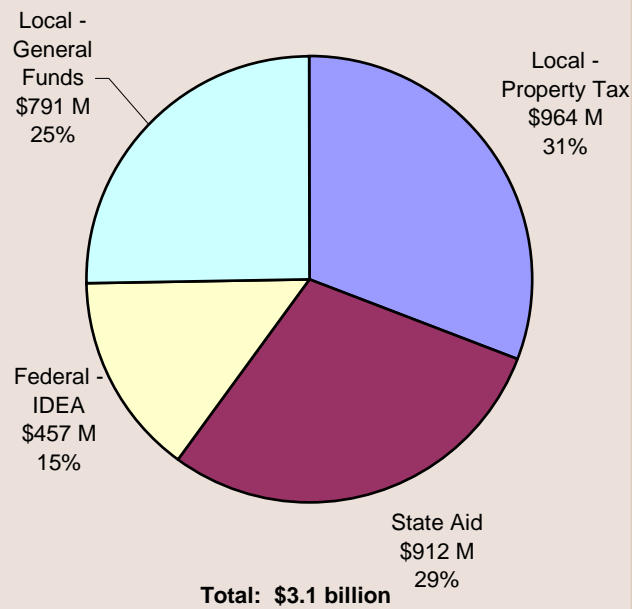
From a historical perspective, the size of the general fund subsidy in FY2010 is somewhat misleading because of the infusion of federal stimulus funds and the significant ARRA-related expenditures in FY2010 (see earlier discussion). Prior to the availability of these one-time resources, the federal share was smaller and other components’ shares (including general funds) were larger as depicted in **Chart 11**. In FY2007, prior to the stimulus funding, the general fund subsidy accounted for 25 percent of all reported costs, the third largest piece and

Chart 10
FY2010 Special Education Revenue



Source: MDE; Michigan Dept. of Treasury; CRC calculations

Chart 11
FY2007 Special Education Revenue



Source: MDE; Michigan Dept. of Treasury; CRC calculations

Table 12
Special Education Revenues by Source: FY2001, FY2007, and FY2010
(Dollar amounts in millions)

	<u>FY2001</u>		<u>FY2007</u>		<u>FY2010</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Local – Prop Tax	\$531	23	\$964	31	\$1,027	30
Local – General Funds	836	37	791	25	655	19
State Aid	685	30	911	29	978	29
Federal	<u>222</u>	10	<u>457</u>	15	<u>735</u>	22
Total	\$2,276		\$3,124		\$3,395	

* Totals may not add due to rounding.

Source: Michigan Department of Treasury; MDE; CRC calculations

larger than the amount of on-going federal IDEA funding (15 percent of the total). Comparing FY2007 to FY2010 suggests that local and intermediate school districts were able to reduce, at least temporarily, the amount of general fund support they supplied for special education because of the availability of sizeable amounts of ARRA resources.

Since the early 2000s, however, statewide data suggests that the general fund subsidy has declined (See **Table 12**). In FY2001, local districts and ISDs supported special education with \$837 million general fund (37 percent of the total), and by FY2007 the general fund share declined both nominally and as a percentage of the total to \$791 million (25 percent of the total). Two other sources made up for the decline in general fund support over the period: the dedicated ISD property tax and fed-

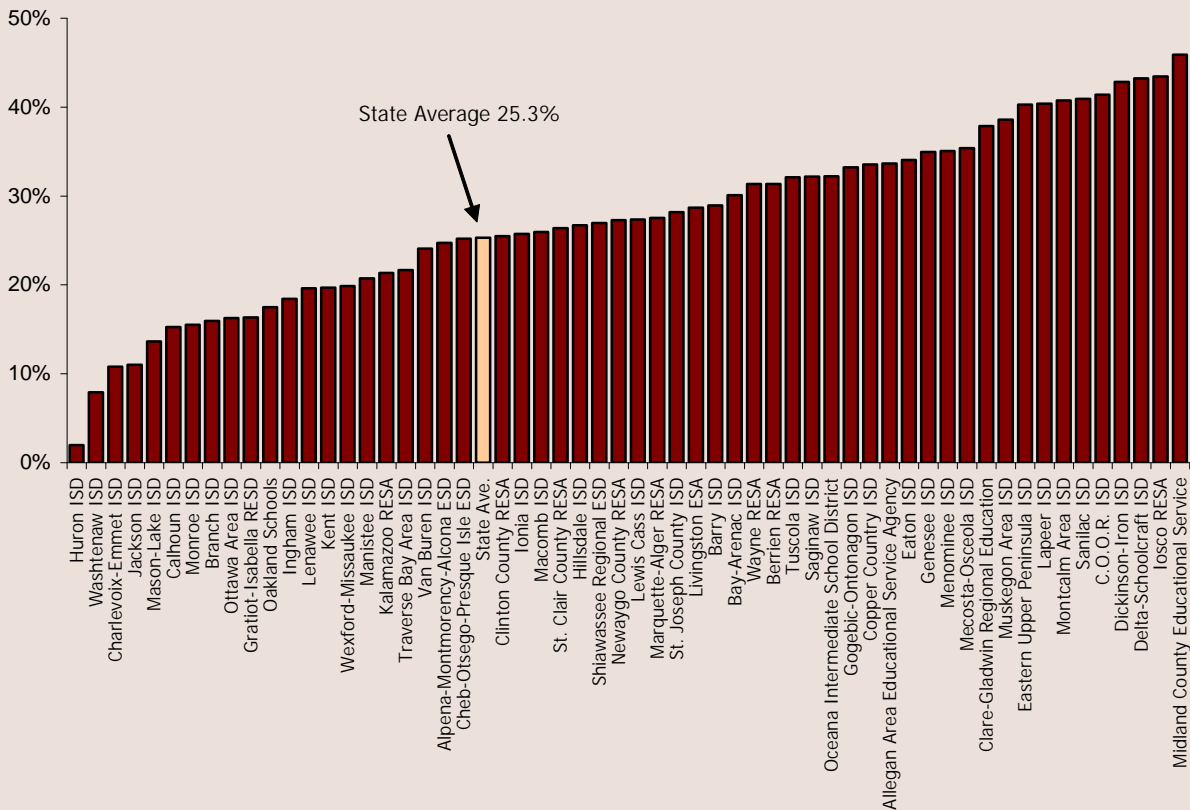
eral IDEA funds. Although the amount of state aid increased during this period with the rise in overall costs, because of the *Durant* financing provision, the percentage of the total remained fixed at roughly 30 percent. The largest increase occurred with the share coming from the local property tax; this source increased 8 percentage points, from 23 percent of the total to 31 percent.

Given the wide variations in spending combined with the differences in local property tax yields noted earlier, it should not be a surprise that the size of the general fund subsidy also varies by ISD across the state. **Chart 12** presents the relative size of the general fund subsidy by ISD in FY2007.²⁷ On a statewide basis, general fund con-

tributions accounted for 25 percent of total revenue. (FY2007 data is used to avoid the different effects that ARRA-related resources had on individual school finances in FY2010.) As can be seen, considerable variation is observed; the size of the general fund subsidy ranged from just 2 percent in Huron ISD to 46 percent in Midland County Education Services Agency (ESA).

The size of the general fund subsidy was not related to enrollment, as some of the ISDs with the most special education students had relatively small subsidies (below the statewide figure of 25 percent): Washtenaw ISD - 8 percent; Oakland Schools - 17 percent; Ingham ISD - 18

Chart 12
General Fund Share of Total Special Education Revenue by ISD in FY2007



Source: MDE; Michigan Dept. of Treasury; CRC calculations

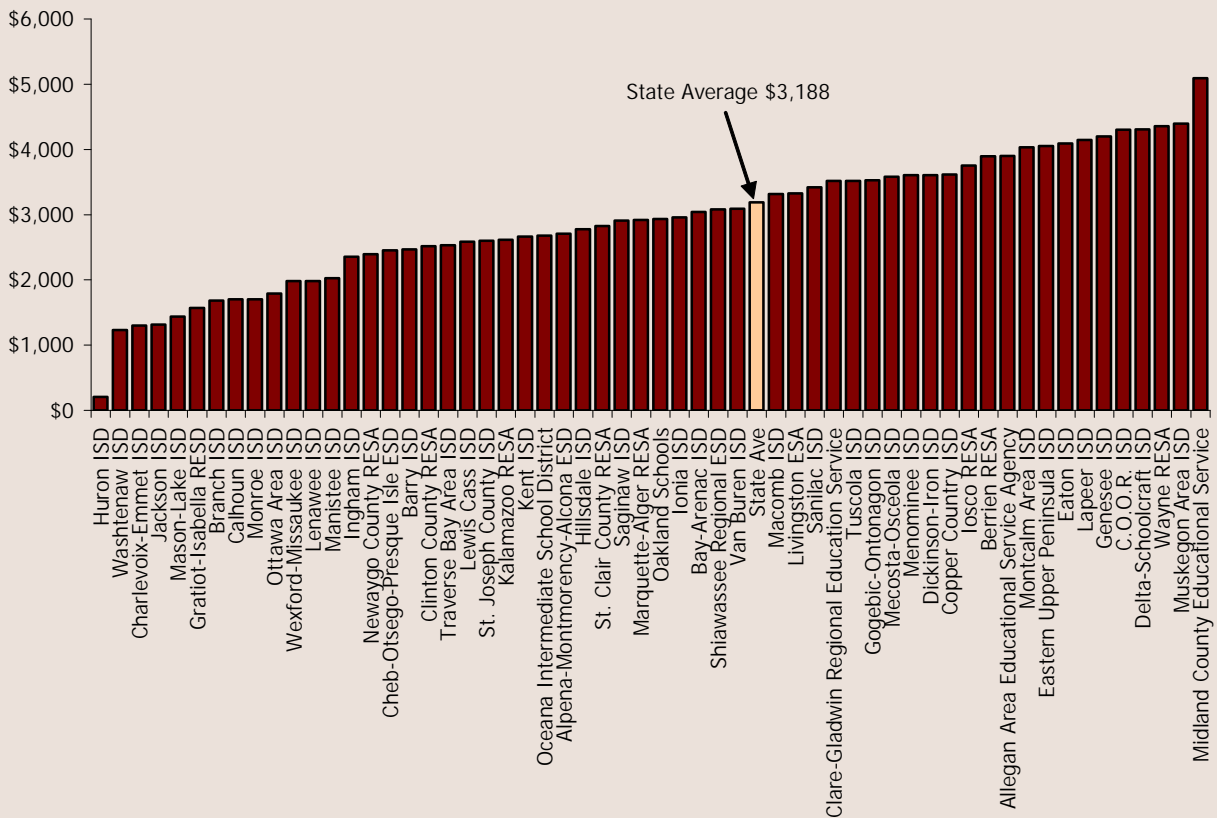
FINANCING SPECIAL EDUCATION: ANALYSES AND CHALLENGES

percent; Kent ISD - 20 percent. However, the largest ISD in the state, Wayne RESA, had a general fund subsidy of 31 percent.

Scaling the total general fund dollars against the number of special education pupils receiving services within each ISD provides a sense of the average per-pupil general fund subsidy. The per-pupil general fund contribution is another way to examine the extent to which general fund resources are augmenting dedicated revenues differently across the state. This information is presented in **Chart 13** (using FY2007 to avoid the effects that the one-time stimulus funding had on district finances). The amount of general fund dollars per pupil ranged from a low of \$205 in Huron ISD to a high of \$5,093 in Midland County ESA. Statewide, the amount of general fund per pupil was \$3,188.

The per-pupil rankings generally mirror those contained in the previous chart and only deviate marginally. Variations across ISDs can be the result of historical funding practices in local constituent districts and the unique relationships that districts have with their parent ISD. It may be the case that some districts simply rely on general fund contributions from their constituent districts and the ISD more than the dedicated local property tax to fund services. More recently, however, variations may be attributable to the poor performance of ISD special education tax yields (a reaction to housing market declines and tax base erosion). As yields decline, larger general fund contributions are required in some communities to meet service demands. Alternatively, some communities may be addressing the property tax revenue declines through reductions in overall spending and other means.

Chart 13
Per-Pupil General Fund Revenue for Special Education by ISD in FY2007



Source: MDE; Michigan Dept. of Treasury; CRC calculations

Challenges Facing Special Education Finances

The financing of the special education services and programs provided to nearly 225,000 students faces a number of challenges: both new and old. In both cases, they must be met by local and intermediate school districts as many services and programs are mandated in state and federal law and districts have few options to curtail or cut back from what is required. Furthermore, districts are finding that the financing challenges exist on both the spending and revenue sides of the special education budget ledger, which adds to the task of finding viable solutions. The unique nature of special education itself (highly-trained personnel, student differences, separate classrooms, etc.) helps explain some of the pressures, while in other instances, the underlying financing mechanisms face built-in obstacles (such as the property tax limitations contained in state law). At the same time that these structural pressures are at work, all public budgets (state and local) have been adversely affected by the recent economic conditions in Michigan arising from the single state and national recession.

At the same time that these challenges are affecting special education budgets, they spill over and effect general education finances, effectively exacerbating the challenges confronting schools' general fund budgets. As previously noted, the general fund budgets of districts are the "funders of last resort" for special education mandates from the state and federal government. As special education costs continue to escalate and dedicated revenues stagnate, general fund budgets are finding themselves increasingly stressed to cover their special education obligations. For state government and the School Aid Fund, the obligations are effectively defined by constitutional provision as interpreted by the Supreme Court's decision in *Durant*. As the growth of the School Aid Fund slows, the *Durant* mandate assumes a larger share of the total resources and leaves proportionately fewer dollars for other K-12 education services.

The following section discusses some of the challenges, both revenue- and spending-related, facing special education. In some cases, these arise from federal and state policy driving expenditures. In other instances, revenue pressures arise from the structure of the taxes designed to support special education or the economic conditions in the state. State policymakers have considerable leverage to effect state and local taxes responsible for fi-

ancing special education. When it comes to federal resources, they have no control over federal policy and the allocation of revenues to the state. Thus, much of the attention is directed at the financing issues that state policymakers have direct control over.

Federal Policy

The federal government has never fully met its financing commitment for special education services under IDEA. While this fact represents a significant strain on local and ISD finances, it is not a new one. The promise of full funding under IDEA (40 percent of costs) has never materialized, even in recent years when sizeable amounts of ARRA funds nearly doubled the IDEA Part B grants states received. While Congressional reauthorization of IDEA in 2004 included gradual increases in federal authorizations (reaching the full funding plateau in 2011), actual appropriations made by Congress (which control the amount states receive) in each year remained well below the authorized levels and far below the full funding level. After nearly 40 years of failing to do so, it is unlikely that the federal

government will meet its full funding promise anytime soon or when reauthorization of the federal law is considered next. Therefore, state governments and local school districts can be expected to continue to shoulder the vast majority of the financing responsibilities associated with federal mandates.

The lack of full federal funding has not stopped the federal government from requiring adherence to existing mandates or imposing new ones. A key requirement under IDEA that states and local schools must meet involves "maintenance of effort" (or MOE). Generally speaking, MOE stipulates that federal grant recipients must demonstrate that the level of state and local funding remains relatively unchanged from year to year. In this sense, federal funds are intended to supplement, not supplant state/local funds for special education. Failure to meet MOE requirements may result in recipients losing eligibility to receive IDEA funding. The rules and the consequences of failing to meet MOE by state government and local districts are different under IDEA.²⁸

Exceptions or waivers to state MOE requirements under IDEA are generally reserved only for "exceptional or un-

At the same time that these challenges are affecting special education budgets, they spill over and effect general education finances, effectively exacerbating the challenges confronting schools' general fund budgets.

controllable circumstances” and can only be issued by the U.S. Secretary of Education for a single year at a time. Until recently, no state had previously asked for a MOE waiver; however, the recent economic recession and its adverse effects on public budgets changed that.

According to the U.S. Department of Education, seven different states requested one or more one-year waiver in 2009, 2010, and/or 2011.²⁹ Many of the waiver requests were granted, either in whole or in part. Michigan was not one of these states. In many cases, public revenues from state and local sources are below pre-recession levels making it difficult to meet the matching requirements that accompany IDEA funds. Although School Aid Fund revenues experienced two years of consecutive declines over the last recession, falling 5.1 percent in FY2009 and 1.0 percent in FY2010, state government is required to cover a set percentage of special education costs per the *Durant* court decision.

Also, in a somewhat ironic twist, the influx of federal dollars from ARRA can allow local districts to decrease their MOE permanently. The reduction in local MOE on an ongoing basis will have the effect of reducing overall spending on special education when the ARRA funds are exhausted (September 30, 2011) beginning in FY2012.

IDEA allows local districts to reduce their spending in specific circumstances; primarily related to situations that lower the overall costs of providing services (e.g., exit of “high cost” staff and students, enrollment declines, etc.). However, another provision allows a district to reduce its MOE when federal allocations increase from one year to the next (as was the case with the stimulus funding in 2009). This little used provision in the federal law allows districts to reduce their local MOE by an amount equal to 50 percent of the increase in federal funds. (A \$1 increase in federal funds coupled with a \$0.50 reduction in local MOE results in a net \$0.50 increase in special education spending.) When a local district exercises this authority, the reduced local MOE becomes permanent; regardless if the increased federal allocation is permanent.

While ARRA nearly doubled IDEA funding in the short run (2009-2011), it will have long-term consequences on total special education funding when the ARRA funds

are gone and if districts take steps to reduce their local MOE prospectively. When the one-time ARRA funds disappear and the local MOE is reduced, total spending on special education will decline. The substantial amounts of ARRA funding that districts received (which determines the size of the local MOE reduction) can reduce total spending to below pre-ARRA levels beginning in 2012. This provision in the federal statute, along with districts’ use of it, has become a heated point of contention among special education advocacy groups.³⁰

State Policy

Special education providers also face fiscal pressures arising from state law and policies. Perhaps the most obvious, at least relative to the federal requirements, has to do with the age of disabled students that are entitled to a free appropriate public education. Michigan law mandates that students receive services until age 26, as opposed to age 21 under the federal IDEA statute. Lowering the state mandated age to align with the federal law would reduce the number of students receiving services and the associated costs to schools.

Lowering the state mandated age to align with the federal law would reduce the number of students receiving services and the associated costs to schools, although any savings are likely to be relatively small.

As of December 2010, a total of 3,237 students with IEPs were between the ages of 22 and 26, representing only 1.4 percent of the total students with IEPs. Unlike students age 6 to 21, the older cohort primarily received services in dedicated special education settings (center-based programs) as opposed to general education settings. Over three-fourths of students age 22 to 26 were enrolled in center-based programs, compared to only 5 percent of students age 6 to 21 that received services exclusively in this setting. Nearly 62 percent of students age 6 to 21 spent at least 80 percent of their day in a general education setting (with special education aides).

Although center-based programs tend to be more expensive to operate on a per-pupil basis, the elimination of services to a relatively small population of students with IEPs (1.4 percent) is not likely to generate significant savings statewide. Any discussion of lowering the age threshold would have to consider Michigan’s longstanding and unique history of providing special education services from birth to age 26. The case for such eligibility changes is not likely to be premised solely on the prospect of future cost savings.

Funding Employer-Required Retirement Obligations

As noted, the higher per-pupil costs associated special education pupils can result from factors that are unique to the special education environment, such as specialized personnel, lower staffing ratios, specialized services (educational and ancillary), and the higher costs of transportation. However, special education spending is also subject to the same major cost pressures that drive all K-12 education spending, most notably employer-paid health care insurance and required retirement contributions to the state-administered system for pension and retiree health benefits.

The Michigan Public School Employees Retirement System (MPERS) is the largest public employee retirement system in the state, providing pension and group insurance benefits, referred to as other post-employment benefits or OPEBs, to retired employees and their eligible dependents. Pension benefits are financed on an advance funding basis while the OPEBs (mostly health care) are on a cash disbursement basis. In both cases, these benefits are predominately funded by employer contributions expressed as a percentage of active employee payrolls. **Table 13** provides a sense of the growing financial pressure on employers associated with funding retirement benefits as the employer contribution rate has nearly doubled since FY2004.

Table 13
Michigan Public School Employees Retirement System Required Employer Contribution Rate (percentage of payroll)

<u>Fiscal Year</u>	<u>Pension</u>	<u>Health</u>	<u>Total</u>	<u>Annual Change</u>
2004	6.94%	6.05%	12.99%	0.00
2005	8.32	6.55	14.87	1.88
2006	9.79	6.55	16.34	1.47
2007	11.19	6.55	17.74	1.40
2008	10.17	6.55	16.72	-1.02
2009	9.73	6.81	16.54	-0.18
2010	10.13	6.81	16.94	0.40
2011	12.16	8.50*	20.66	3.72
2012	15.96	8.50*	24.46	3.80
2013	18.62	8.75*	27.37**	2.91
Percent Change:				
FY2004 - FY2012	130%	40%	88%	

* Includes the employee-required 3.0 percentage point contribution under PA 75 of 2010 that is currently the subject of the lawsuit *Deborah McMillan, et al v. MPERS, et al.*

** projected rate

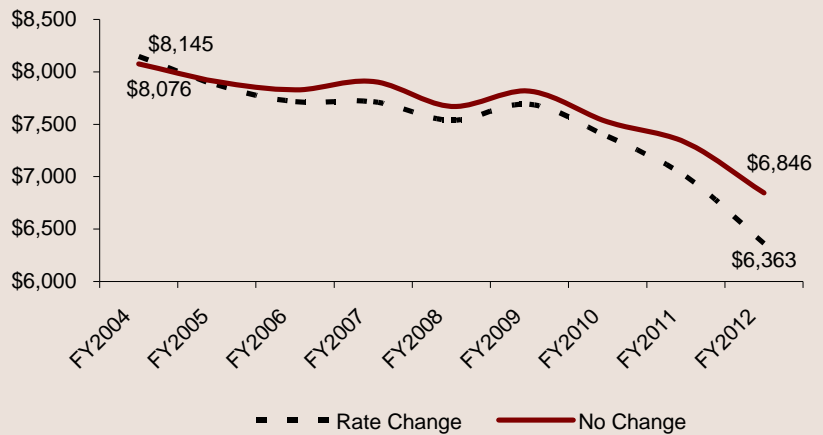
Source: Department of Technology, Management and Budget, Office of Retirement Services

The effects of the changes in the employer contribution rate have reduced the value of per-pupil funding provided to districts for both general and special education. **Chart 14** compares the growth of the inflation-adjusted minimum foundation grant with and without the rate changes since FY2004. While inflation has reduced the purchasing power of the grant, the increase in the contribution rate has had a profound effect too. As can be seen in FY2012, the changes in the rate alone reduced the purchasing power of the grant by \$480.

The degree to which MPSERS funding weighs on special education finances varies based on the percentage of a district's workforce that is covered by the system. For traditional public schools and intermediate school districts, the vast majority of their employees are members of MPSERS. In contrast, many public school academies (charter schools) have chosen not to participate in the system. Thus, annual MPSERS obligations are a more significant burden for traditional districts than charter schools, although recent law changes (if upheld in court) will provide some measure of fiscal relief for the non-charter entities.

Recent state law changes were enacted to address the growing financial liability of employers for these required annual contributions, including creating a new pension plan for new hires and shifting some employer costs to employees.³¹ Specifically, one change requires employees to contribute 3 percent of their salary into an irrevocable trust to help finance retiree health care costs. The net effect of the various legislative changes is estimated to yield savings of \$3.3 billion over a 10-year period.³² Further reforms, such as shifting all new employees to a defined contribution plan for pension benefits, also have been considered by policymakers; however, the up-front costs with such a switch, among other concerns, have stymied further reforms.³³ Another possible reform is seen in recent changes made by the State of Michigan to its primary pension plan (State Employees' Retirement Sys-

Chart 14
Effect of MPSERS Retirement Contribution on Basic Grant



* Basic grant adjusted for inflation (constant FY2012 dollars)

tem). These reforms eliminate retiree health insurance coverage for new employees and instead provide matching funds to a tax-deferred account, which will generate substantial employer savings in both the short- and long-term.³⁴

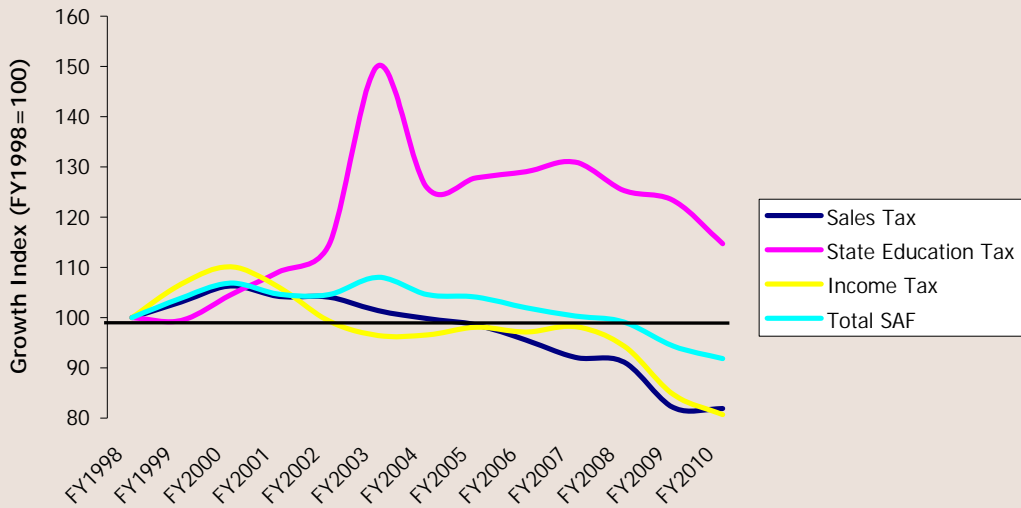
School Aid Fund and State Aid

The state's obligations under the *Durant* settlement, along with other state costs associated with special education (categorical grants), are financed by the School Aid Fund. The performance of the School Aid Fund over the past decade has not kept up with the state's special education funding responsibilities. The escalating demands on School Aid Fund resources arising from *Durant* create pressures on the amount of funding available to support general education appropriations in the State School Aid Act, namely the foundation grant. These pressures are not likely to abate without significant changes in the special education population or the growth of special education costs.

The School Aid Fund received the vast majority of its total revenues (\$10.8 billion in FY2010) from portions of three state taxes; Sales Tax (represented 42 percent of the School Aid Fund revenue), State Education Tax (18

The effects of the changes in the employer contribution rate have reduced the value of per-pupil funding provided to districts for both general and special education.

Chart 15
Growth of School Aid Fund Revenue: FY1998 to FY2010



Source: MDE; Bureau of Labor Statistics; CRC calculations

percent), and Personal Income Tax (17 percent). Other minor sources that contributed to the School Aid Fund included an earmark of the Michigan Business Tax (7 percent), net state lottery proceeds (6 percent), and Use Tax (4 percent).³⁵ Growth of the School Aid Fund since the *Durant* settlement has been decidedly dismal (See **Chart 15**).

The growth of two of the major School Aid Fund tax sources (sales and income), as well as the growth of total revenue, failed to keep pace with inflation since FY2000. Although initial growth of all major sources was strong, Michigan's economic struggles in the early part of the 2000s weighed on revenue collections dedicated to financing K-12 education. The national recession further reduced inflation-adjusted revenues in the later part of the decade. Annual growth of the School Aid Fund also struggled to keep pace with changes in economic activity (such as personal income) because of growing weaknesses in the connection between the structure of education taxes and the broader state economy.³⁶ One notable example important to the amount of sales tax receipts involves the

steady, gradual shift towards the consumption of services. School funding is harmed because Michigan law currently exempts nearly all consumer services from the sales tax.

At the same time that dedicated revenues to the School Aid Fund failed to keep up with inflation, state policymakers reduced the amount of discretionary General Fund resources allocated to the School Aid Fund in their efforts to help manage the budget challenges in the General Fund.

For the majority of the time since FY1998, the School Aid Fund benefited from historically strong growth of the 6-mill state property tax; however, this abated in recent years with the downturn in the housing market and the attendant reductions in the tax base. This problem also is affecting the revenues generated from local special education taxes.

At the same time that dedicated revenues to the School Aid Fund failed to keep up with inflation, state policymakers reduced the amount of discretionary General Fund resources allocated to the School Aid Fund in their efforts to help manage the budget challenges in the General Fund. Since FY1998, the General Fund contribution to the School Aid Fund was reduced nearly \$350 million, from \$376 million to just \$28 million in FY2010. More recent state budget decisions have assigned the School Aid Fund with additional financing responsibilities. Under

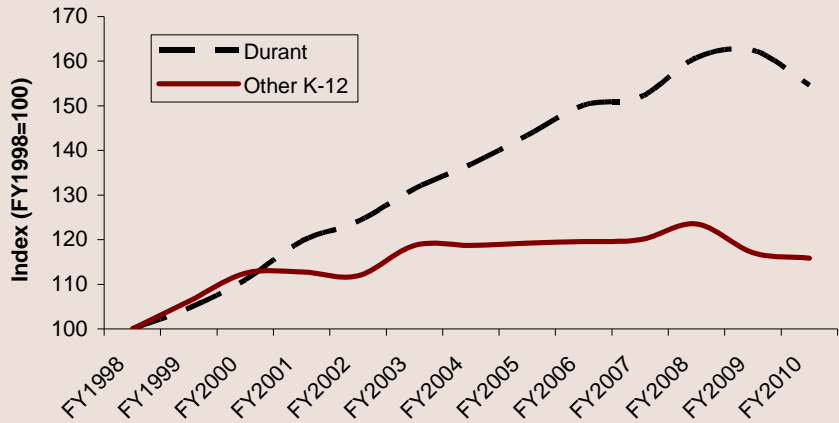
the FY2012 budget, the School Aid Fund will cover nearly \$400 million in state higher education appropriations that were previously financed by the General Fund. As the School Aid Fund grows with Michigan's economic recovery in FY2012 and beyond, K-12 education finances find that they must compete for these dollars with the demands on state resources from higher education institutions. It is not entirely clear that additional School Aid Fund dollars, prospectively, will be directed to K-12 education.

The decrease in School Aid Fund purchasing power since FY2000, combined with the inflation-adjusted growth of special education costs over the same period, meant that proportionately more School Aid Fund dollars had to go towards satisfying the *Durant* mandate. This has left fewer resources for other K-12 education services, namely the per-pupil foundation grant. *Durant* obligations, as a percent of total School Aid Fund revenue, grew steadily from 6.2 percent in FY1998 to 8.4 percent in FY2009, before falling to 8.1 percent in FY2010. **Chart 16** compares the growth in the share of the School Aid Fund going towards *Durant* and the growth in the share available for all other K-12 education responsibilities. *Durant* obligations grew 55 percent since FY1998 compared to 16 percent for all other K-12 spending. Had the share of the School Aid Fund going to meet the state's *Durant* obligations remained steady at 6.2 percent there would have been over \$200 million more available for other K-12 spending in FY2010.

Property Tax Limitations

For most districts, the ISD special education property tax is the primary funding source for services and programs. For those where it is not the largest single source, it is a close second behind state aid. This tax, like all other local property taxes, faces both constitutional and statutory limitations on the growth of the tax base. Also,

Chart 16
Growth of *Durant* Obligations Compared to Other K-12 Spending from School Aid Fund



Source: MDE; CRC calculations

The decrease in School Aid Fund purchasing power since FY2000, combined with the inflation-adjusted growth of special education costs over the same period, meant that proportionately more School Aid Fund dollars had to go towards satisfying the *Durant* mandate.

there are hard caps on the maximum rate allowed (1.75 times 1993 rate). As noted previously, property assessments and taxable values have been falling throughout the state. This phenomenon affects all types of local governments including general purpose (cities, counties) as well as special purpose (schools) entities. The decline in values has accelerated and has become more pervasive statewide in recent years, causing substantial tax yield losses. Coming out of the current period of declining property values, the interaction of the Headlee Amendment's tax limitations and Proposal A's assessment cap will forestall recovery in the tax bases of school districts, effectively prolonging the effect of the current housing market downturn.

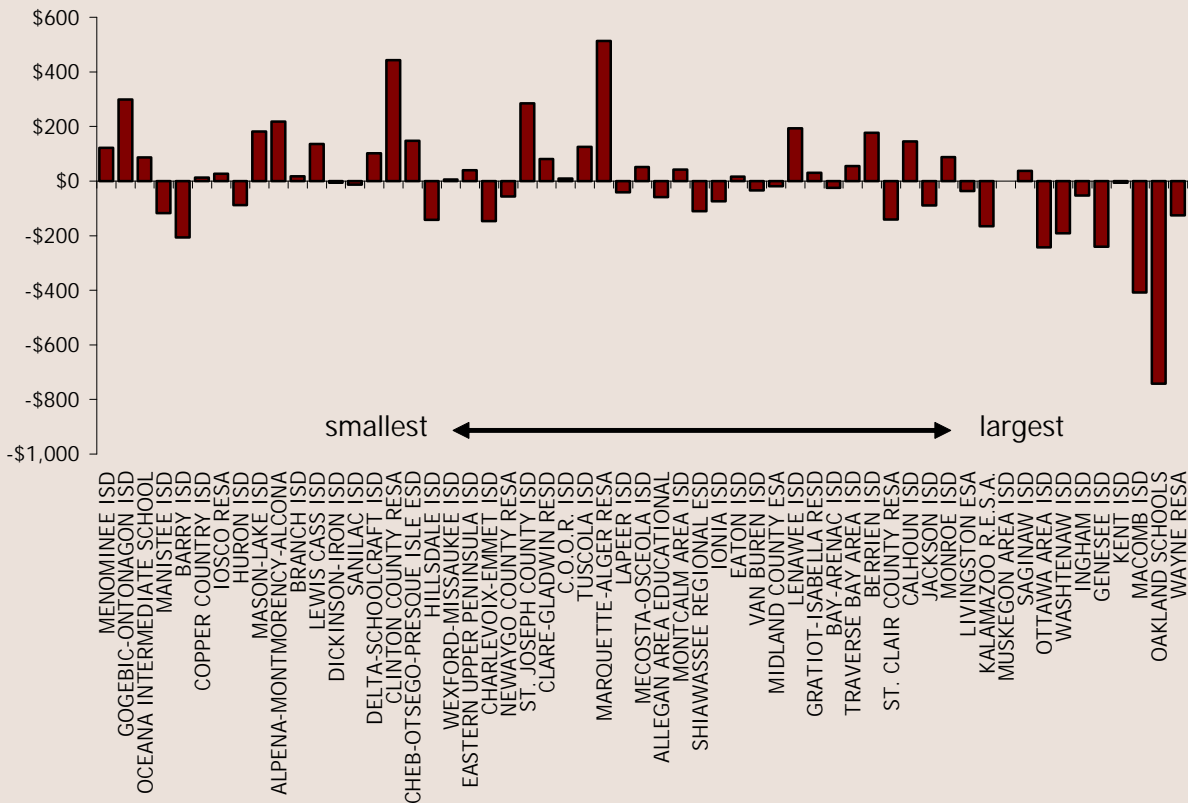
As a result of falling property values, districts statewide experienced an aggregate special education property tax yield loss of nearly \$11 million in 2010 and another \$71 million in 2011 with the continued deterioration of the housing market. Some per-pupil losses were absorbed by the shrinking special education population over the period. On a per-pupil basis, revenues increased slightly (\$34 per pupil) in 2010 before declining \$142 per student in 2011. Further losses are ex-

pected in 2012 and beyond, the extent of which is unknown at this time.

A total of 49 ISDs experienced a reduction in their total tax yield in 2011. Because of the reduction of students in many districts, only 27 districts had reductions in their per-pupil tax yield. **Chart 17** shows the range of year-over-year per-pupil revenue changes by ISD. Eight of the top ten largest districts (right side of chart) experienced per-pupil revenue declines with an average reduction of \$263 per student in 2011.

With little ability to control the tax base upon which the special education millage is levied, ISDs may be expected to seek local voter approval to raise tax rates (if they have not done so already) in response to lower tax yields. For some districts, voter approval will be sought to override previous Headlee tax rate rollbacks and to raise rates up to the amount currently authorized to make up for the revenue losses. Others, who are already at the rate currently authorized, will have to ask for local permission to increase the maximum rate, up to the amount allowed under the Proposal A-related changes (1.75 times 1993 rates).

Chart 17
Per-Pupil ISD Special Education Tax Yield Change: 2010 to 2011
(districts ordered by population)



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Evidence of previous Headlee tax rate rollbacks is seen in **Chart 18**. In 2000, the average rate for the various ISD special education millages statewide was 92.1 percent of the maximum and by 2008, districts were levying property taxes at 90.4 percent of the maximum rate.³⁷ This chart also shows the distribution of districts based on a comparison of each district's actual tax rate compared to their currently authorized tax rate. Fifteen districts are within 5 percentage points of their currently authorized rate. For these districts, overriding previous Headlee rollbacks may be insufficient and they may have to request voter approval to raise the maximum rate; a step taken by a handful of few districts previously.

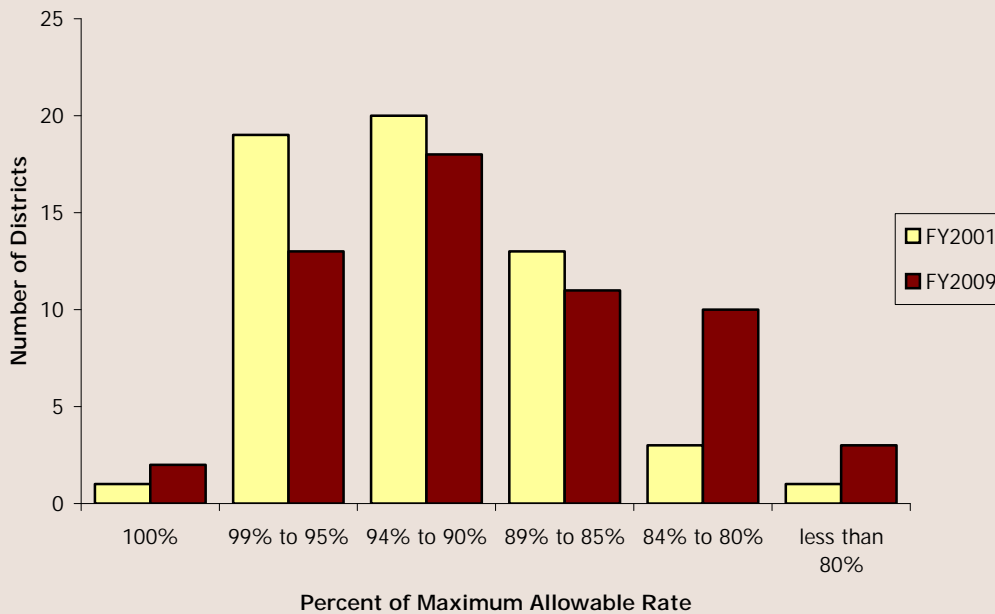
As more districts seek to raise rates as a response to falling property values, the issue of the fixed nature of the Proposal A tax rate cap will become an issue.

Since Proposal A's adoption, 17 ISDs have take the necessary steps to ask voter approval to raise their special education tax rate above the rate in effect in 1993. Three-fourths of districts have not requested this authority and still have this option at their disposal. In one-third of the cases (six districts), the rates were raised to the maxi-

imum allowed (1.75 times the 1993 rate). For these districts, overriding previous Headlee rollbacks may be the only response to falling property values to restore lost revenues.

The Proposal A reforms established the maximum tax rates that ISDs can levy for various purposes, including special education. These limits were established in a different environment, and most likely, based on assumptions that proved to be false (i.e., sustained and consistent property value escalation). Although the caps on these rates did not prohibit rate increases altogether, the question arises whether these caps should be reviewed periodically, especially in light of the fact that they were established nearly 20 years ago. This is a significant issue for some districts that are already at their state-imposed maximum rate. As more districts seek to raise rates as a response to falling property values, the issue of the fixed nature of the Proposal A tax rate cap will become an issue.

Chart 18
ISD Special Education Tax Levies: FY2001 and FY2009



Source: CRC survey of ISDs

As previously noted, a number of ISDs have managed to secure voter approval to increase tax rates either in response to Headlee rate rollbacks or to augment programs and services provided to constituent districts. Many more are expected to increase rates in the coming years in response to falling property values. In some instances, districts failed to garner the requisite approval to increase their special education millage rate to make up for the property tax base losses (see box below). A review and potential adjustment to the maximum ISD tax rates might provide future stability to district funding levels, especially for those that have exhausted their ability to raise rates.

General Fund Budget Pressures

The fiscal pressures faced by special education financing are also affecting the districts' general fund budgets. In light of the historical role that general fund resources have served, these pressures cannot be considered new. However, looking forward and based on the performance of dedicated property tax revenues, the demand for general fund resources is likely to rise.

The call for more general fund support comes at a time when general fund budgets face a host of challenges of their own.

The most recent pressure on general fund budgets comes from the performance of dedicated special education property tax yields. Statewide, yields declined nearly \$11 million in 2010 and \$71 million in 2011; however, the local impact varies widely based on the extent of the

Statewide, property tax yields declined nearly \$11 million in 2010 and \$71 million in 2011; however, the local impact varies widely based on the extent of the housing market downturn in each community. Further tax base erosion is projected in 2012, which will extend the pressure at least another year. Some local communities are likely to experience further declines for the next two to four years.

housing market downturn in each community. Further tax base erosion is projected in 2012, which will extend the pressure at least another year. Some local communities are likely to experience further declines for the next two to four years. Coming out the period of taxable value declines, growth of property tax yields will be constrained by state constitutional tax limitations, effectively limiting growth to inflationary increases. Therefore, the demand for general fund resources to effectively make up for lost property tax resources is not likely to abate in the near future.

Making matters worse for many districts' general fund budgets is the fact they have had to manage reductions in state aid (e.g., per-pupil foundation reductions). Per-pupil foundation reductions do not have the same effect on special education because of the requirement for the state to fund a fixed percentage of special education costs. Some general fund budgets are forced to absorb the cuts in state aid at the same time they face rising personnel costs (on a per-employee basis), driven primarily by health care spending. Traditional

public school districts also face spending pressures from increases in required employer contributions for retirement benefits (pension and retiree health costs). Thus, the federal and state mandates to fund special education services and programs at specific levels exacerbate the fiscal challenges facing general education.

The demand for greater shares of general fund resources is also seen in the state's budget. The portion of the

School Aid Fund annually directed to special education has increased consistently over the last 12 years, leaving proportionately less resources for other K-12 education services and programs. By law, the School Aid Fund is responsible for a fixed percentage of costs, regardless of the amount of available state resources and regardless of the growth in these costs. If the annual growth of costs exceeds the growth of the School Aid Fund, proportionately more state funds will have to go to special education. This leaves fewer resources available to the “general purpose” (general education) portion of the School Aid Fund. Since the *Durant* decision, the portion of the School Aid Fund going to support special education mandates has grown from 6.2 percent in FY1998 to 8.4 percent in FY2010.

The recent state budget decisions to allocate \$400 million of the School Aid Fund to finance higher education appropriations accentuate the special education demands, leaving even fewer resources for general education purposes. In FY2010, statewide special education costs arising from the *Durant* decision declined for the first time. If this continues, the School Aid Fund may see some relief; however, if statewide costs return to their historical trend then additional School Aid Fund

dollars will have to be directed away from over K-12 education purposes toward special education.

Michigan's experience is not unique. Nationally, and for some time, the growth in special education spending has assumed larger shares of total education spending; leaving fewer dollars available for general education purposes.

A survey of nine school districts across the country over nearly a 40-year period (1967 to 2005) revealed that most of the inflation-adjusted increase in school spending had not been directed at general academic programs. Instead, the majority of the funding increases were devoted to special education services.³⁸ From 1996 to 2005, real per-pupil spending for general education increased 2.4 percent per year on average compared to 4.6 percent per year for special education. The share of total per-pupil spending that went to special education over this period increased from 18.3 percent to 21.0 percent, a 2.7 percentage point increase. In contrast, general education's share of per-pupil spending shrank from 57.4 percent to 55.0 percent, a 2.4 percentage point decrease. (Other smaller program areas (food services, pupil support, vocation education, transportation) accounted for the remainder of the total.

The recent state budget decisions to allocate \$400 million of the School Aid Fund to finance higher education appropriations accentuate the special education demands, leaving even fewer resources for general education purposes.

Conclusions

In many respects, the financial challenges faced by local and intermediate school districts responsible for providing special education services to nearly 225,000 students in Michigan are not unique. Both general K-12 and special education finances confront some of the very same obstacles as do the budgets of other public entities; cuts in state aid accompanied by reductions in dedicated property tax yields in an environment of rising costs. Similarly, many of the challenges are not new; however, the recent economic downturn has brought them into clearer public focus and, in many cases, increased the magnitude of the fiscal problems for many local schools.

Despite sharing similar fiscal problems with other entities, the challenges found in special education finance may be harder to address because of the inherent complexity found in the special education governance and finance structures. For example, substantial amounts of revenue come from all three levels of government, some of which are strictly earmarked and some of which entail considerable discretion. In contrast, the majority of general K-12 operating revenues originate with state-level taxes controlled by policymakers in Lansing. On the other hand, the local dedicated special education property tax, the largest single source statewide, is strictly governed

by constitutional and statutory limitations that control the rate and base. Within these limitations, local property taxation decisions rest with school officials and local communities, not state-level decision makers. Neither state nor local officials have any measurable control over the federal policies that govern special education spending or that determine the amount of federal resources the state receives each year. The federal government is not expected to make good any time soon on its nearly 40-year old promise to fund 40 percent of special education costs.

Added to the structural complexities are the complexities that originate with the student population being served. Unlike general education students where educational needs are largely uniform, children with disabilities often exhibit very unique educational needs, requiring additional direct and ancillary services. Schools struggle to “standardize” the education provided to these students and as a result, the additional services substantially increase the per-pupil cost. Because state and federal mandates require that every child receive a free appropriate public education in the least restrictive environment, school districts have little options but to meet these needs, often times, regardless of the costs involved in doing so.

FINANCING SPECIAL EDUCATION: ANALYSES AND CHALLENGES

Endnotes

¹ The total number of students with IEPs and the total number of students (head count) comes from the Michigan Department of Education, Office of Special Education, Michigan Compliance Information System Data Portrait. These numbers differ from the head count data reported by the Center for Educational Performance Information because of the ages of individuals included by each entity and the date of each count.

² Cognitive impairment, emotional impairment, hearing impairment, visual impairment, physical impairment, speech/language impairment, early childhood development delay, specific learning disability, severe multiple impairments, autism spectrum disorder, traumatic brain injury, and deaf-blindness.

³ For this discussion, only traditional public school districts (not charter schools) are included for two reasons. First, because of the establishment of new schools and the closure of others during the time period of interest, it is difficult to get a clear picture of schools that gain and lose population. Second, many charter schools, as they grow, will add a grade each year which makes it difficult to determine whether special education enrollment changes are the result of adding grades or additional students in existing grades.

⁴ Michigan Department of Education. "2008 Public School Academy Report to the Legislature." www.michigan.gov/documents/mde/2008_Exec_Summary_278123_7.pdf

⁵ The State School Aid Act limits categorical reimbursement to direct costs approved by the Department of Education and a portion of the indirect costs for operation and maintenance. Funding provided under the federal Individuals with Disabilities Education Improvement Act (IDEA) is subject to the same criteria as the state-reimbursed programs. The expenditure total presented here includes all direct special education costs that are reported to the Department on the Special Education Actual Cost Report (SE-4096) and the transportation expenditures that are reported on the Transportation Expenditure Report (SE-4094). Federal expenditures include those items contained in the IDEA reporting.

⁶ Jay G. Chambers, Thomas B. Parrish, and Jennifer J. Harr. "What Are We Spending on Special Education Services in the United States, 1999-2000?" Special Education Expenditure Project. Center for Special Education Finance, American Institutes for Research. June 2004. www.csef-air.org/publications/seep/national/AdvRpt1.PDF

⁷ Michigan Department of Education, Office of Special Education and Early Intervention Services. "Comparison of General Education and Special Education Costs for the 2006-07 School Year." November 2008. www.michigan.gov/documents/mde/06-07CostComparison_258002_7.pdf

⁸ Jay G. Chambers, Jamie Shkolnik, Maria Perez. "Total Expenditures for Students with Disabilities, 1999-2000: Spending Variation by Disability." Special Education Expenditure Project. Center for Special Education Finance, American Institutes for Research. June 2003. www.csef-air.org/publications/seep/national/Final_SEEP_Report_5.PDF

⁹ For this comparison, per-pupil spending at the ISD level is compared. Services available to individual local districts will be consistent at this level of analysis. Also, revenues available to local districts are much more uniform at the ISD level as opposed to the individual district level. Further, there are 57 ISDs to examine as opposed to nearly 800 local education agencies. Only special education costs (SE-4096 report) are compared, while transportation costs (SE-4094) are excluded. Transportation is a discretionary service and the mix of districts (within an ISD) choosing this service statewide will vary which will affect the average spending figure.

¹⁰ Citizens Research Council of Michigan. *Distribution of State Aid to Michigan Schools*. Report 371. August 2011. www.crcmich.org

¹¹ Under the State School Aid Act, the state is responsible for 100 percent of the costs of operating certain special education programs and services for: 1) pupils assigned to a district through a community placement program of the courts or state agency; 2) resident pupils of an institution operated by the Department of Community Health; 3) former disabled resident pupils of the Department of Community Health placed in community settings; 4) pupils of Michigan Department of Education-approved on-grounds educational program; and 5) pupils placed in a district by parent in order to provide a suitable home.

¹² One reason why transportation costs are reported separately is because these services (for general and special education students) are not mandatory under The Revised School Code and many local school districts (primarily charter schools) do not provide the services.

¹³ Included in the direct operating costs are indirect costs allowed under the State School Aid Act. The Act allows districts to include an amount of up to 115 percent of the approved direct costs in their request for state reimbursement.

¹⁴ Thomas Parrish, Jennifer Harr, Jennifer Anthony, Amy Merickel, and Phil Esra. "State Special Education Finance Systems, 1999-2000." Center for Special Education Finance, American Institutes for Research. May 2003. www.csef-air.org/publications/csef/state/statpart1.pdf

¹⁵ Michigan Department of Education, Office of Special Education and Early Intervention Services. Allowable Cost Guide State Aid & IDEA Section 611, Part B, and Transportation Allowable Expenditures for 2010-11 and 2011-12. www.michigan.gov/documents/mde/Transportation_Allowable_Expenditures_359241_7.pdf

¹⁶ Kathryn Summers-Coty and Joe Carrasco. "Durant: Past and Present." Senate Fiscal Agency. January/February 2001.

¹⁷ The total foundation revenue is calculated by using the "pupil membership" for each district, which is calculated from two separate enrollment counts. Each count is weighted differently and added together to arrive at the membership figure used. For FY2012 (current school year) the pupil membership uses a 90/10 blend and is comprised of 90 percent of the number of FTE pupils from the fall 2011 count and 10 percent of the number of FTE pupils from the spring 2011 count.

¹⁸ The Michigan School Aid Act Compiled and Appendices. House Fiscal Agency and Senate Fiscal Agency. November 2006.

¹⁹ For example, Section 56 authorizes a state payment to equalize ISD special education millages for those districts with per-pupil taxable values below a certain amount. These dollars are intended to help supplement the ISD special education levies in districts with low per-pupil property wealth.

²⁰ Under IDEA, full funding is calculated at 40 percent of the national average per pupil expenditure (APPE) times the number of children with disabilities served. Under the Act, the count of children with disabilities cannot exceed 12 percent of the state's total school population.

²¹ Federal Funds Information for States. "What if the Federal Government Fully Funded IDEA? Issue Brief 07-32. July 19, 2007.

²² New American Foundation. "Background & Analysis: Individuals with Disabilities Education Act - Funding Distribution." June 7, 2011.

²³ The three-part formula consists of: 1) Base allocation equal to 75 percent of the FY1999 ISD payment; 2) 85 percent of the remainder on a per-pupil basis using K-12 public/non-public student count; and 3) 15 percent of the remainder on a per-pupil basis using free lunch student count. www.michigan.gov/documents/mde/OSE-EISMemo09-10_274690_7.pdf

²⁴ Michigan Department of Community Health, unpublished data obtained January 2012. As of January 2012, final cost settlement for FY2012 was completed for 41 districts totaling \$118 million.

²⁵ Michigan Department of Education, Office of Special Education and Early Intervention Services. "Michigan Medicaid School-Based Services (SBS) Program Helps Cover the Costs of School Health Care Services." Focus on Results. Volume #8, Issue #2. February 2010. www.focus.cenmi.org/wp-content/uploads/2010/02/Medicaid_01_21_10.pdf

²⁶ For this calculation, total state costs include those reported on the Michigan Department of Education reports, SE-4096 and SE-4094. Excluded are costs and revenues associated with Medicaid services provided through the School-Based Services program. These costs are not eligible for state reimbursement under the State School Aid Act. Also, Medicaid data is not readily available from the Michigan Department of Community Health. Generally, Medicaid costs/revenues account for a relatively small share; less than five percent in many ISDs. Inclusion of these costs/revenues would increase the total costs (above \$3.4 billion) slightly and reduce the relative share of each major source.

²⁷ For this analysis, total state costs are calculated for each ISD. This total includes costs for each ISD and the local constituent districts that reside within each ISD using the Department of Education cost reports, SE-4096 and SE-4094. After accounting for all dedicated revenues that support these costs (federal, state aid, and local property tax), the remainder is considered the general fund subsidy. No attempt is made to determine whether these are general fund dollars from the local district or the ISD because the level of analysis is the ISD (similar to methodology used in the discussion of per-pupil spending by ISD).

²⁸ IDEA Money Watch. "Maintenance of Effort: The Basics." October 2011. http://ideamoneywatch.com/docs/MOE_basics.pdf

²⁹ U.S. Department of Education, Special Education & Rehabilitative Services. State Maintenance of Financial Support Waivers under Part B. www.ed.gov/policy/speced/guid/idea/monitor/smfbs-partb-waivers.html

³⁰ The Advocacy Institute, Center for Law and Education. "Public comment to the National Council on Disability. How IDEA Federal Funding Anomalies and Policy Shifts Threaten FAPE for Students with Disabilities." December 8, 2011. <http://advocacyinstitute.org/>

³¹ Public Act 75 of 2010 made major changes to MPSERS, including requiring mandatory employee contributions for health care and establishing a hybrid plan (combined defined contribution/defined benefit) for new employees. Various provisions of the Act are the subject of the lawsuit, *Deborah McMillan, et al v. Michigan Public Schools Employees Retirement System, et al.*

³² House Fiscal Agency. Legislative Analysis of Public Act 75 of 2010. June 2010. www.legislature.mi.gov/documents/2009-2010/billanalysis/House/pdf/2009-HLA-1227-8.pdf

³³ House Fiscal Agency. Memorandum: Converting MPSERS from a Defined Benefit (DB) to a Defined Contribution (DC) System. February 2010. www.house.mi.gov/hfa/PDFs/DB%20to%20DC%20Memo%202010.pdf

³⁴ Senate Fiscal Agency. Legislative Analysis of House Bills 4701 and 4702. December 2010. www.legislature.mi.gov/documents/2011-2012/billanalysis/Senate/pdf/2011-SFA-4701-C.pdf

³⁵ A series of state tax changes enacted in 2011 will change the composition of the School Aid Fund beginning in FY2012. Most notably will be the elimination of the Michigan Business Tax earmark (\$740 million in FY2011) that accompanied the replacement of the Tax with a new Corporate Income Tax.

³⁶ The Citizens Research Council of Michigan explored the structural problems with the state's tax system in two reports, Report 349, *Michigan's Fiscal Future*, and Report 363, *State and Local Revenues for Public Education in Michigan*. www.crcmich.org

³⁷ In 2009, the Citizens Research Council of Michigan worked with Macomb ISD to collect historical special education tax rates for all 57 districts; information which did not exist previously in a single place. Districts provided information pertaining to authorized millage rates and actual millage rates for three years 1993, 2000, and 2008. The 1993 rates are the "base" upon which the statutory limitations contained in state law (1.75 times 1993 rate) are applied. CRC examined the authorized and actual rates for 2000 and 2008 and compared them with the 1993 rates to determine how much room, if any, individual districts had under both the currently authorized limitation as well as the state-imposed cap (1.75 times 1993 rate). This information was used in Report 363, *State and Local Revenues for Public Education in Michigan*.

³⁸ Juan Diego Alonso and Richard Rothstein. "Where Has the Money Been Going? A Preliminary Update." Economic Policy Institute. October 2010. www.epi.org/publication/bp281/