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New K-12 Education Budget Generates Significant Swings in Per-Pupil Funding

In a Nutshell

- In lieu of a per-pupil foundation allowance increase next year, policymakers opted for a different approach to providing school districts with increases to their general operating funding.
- A new $598 million School Aid Fund appropriation to be shared among the state's 530-plus traditional school districts will result in very different per-pupil amounts, including schools with similarly sized student enrollments.
- Notably, this variation will widen the per-pupil funding disparity between high-poverty districts and low-poverty districts, something that does not occur when state policymakers use the foundation allowance as the primary mechanism to distribute state aid to schools.

Staring down a self-imposed July 1 deadline to complete the state budget for the fiscal year that begins on October 1, Michigan lawmakers approved the $20.6 billion K-12 education budget during the early morning hours of June 27. The contents of the final product proved a big surprise for K-12 education stakeholders and capital observers. That is because, for the first time in over a decade, the school spending plan does not include a bump in the base per-pupil funding all districts receive.

In lieu of an increase to the per-pupil foundation allowance next year, policymakers opted for a different approach. School districts, with help from the state, are charged an annual contribution toward the pension and retiree health care legacy debts of the school employee pension system. The budget allocates $598 million to reimburse districts for one-quarter of that contribution, thus freeing up existing discretionary funding for other purposes. While the reimbursement funding has been justified by Governor Whitmer and some lawmakers as an equivalent $400 per-pupil foundation bump, a deeper analysis reveals that it is anything but.

Unlike an increase to the foundation allowance that guarantees the same per-pupil funding for all 1.4 million Michigan public school students, the new reimbursement payments will result in very different per-pupil amounts across the state's 530-plus school districts. Several districts are slated to receive more than two times the change in per-pupil dollars of other similarly situated districts. Notably, this variation will widen the per-pupil funding disparity between high-poverty districts and low-poverty districts, something that past school funding budgets have worked to overcome and something that does not occur when state policymakers use the foundation allowance as the primary mechanism to distribute state aid to schools.

Budget Resources Freed Up with Retiree Health Care Liabilities Paid Off

The state-sponsored retirement system for public K-12 school and community college employees, the Michigan Public Schools Employees' Retirement System (MPSERS), provides both pension and retiree health care benefits to eligible school employees upon their retirement. As of the end of the Fiscal Year (FY)2023, the pension portion of the system had nearly $30 billion in unfunded obligations (the gap between what has been set aside and what actuaries determine is needed to cover current and future pension benefits). That represents a funded ratio of 68 percent. At the same time, the MPSERS retiree health plan was "over-funded" and had $2.7 billion in assets more than the plan's liabilities, representing a funded ratio of 127 percent.

A funding floor provision contained in state law, and in effect since FY2018, requires that until the unfunded pension and health care liabilities are fully funded, the annual contribution amounts to retire these debts must be at least equal to the prior year's amounts. The intent of that floor is to accelerate the paydown of these unfunded liabilities. For instance, if financial markets are strong and pension fund investment earnings are greater than what was assumed, actuaries would suggest the annual contribution could come down in future years. A floor ensures that doesn't happen. It prioritizes paying down the liabilities by requiring the annual contribution to stay level. Given the positive experience of the retiree health care portion over the last several years, the floor helped eliminate these liabilities much sooner than would have occurred if the state and local schools had only contributed the actuarially-determined amounts toward these debts.

Since FY2013, the State of Michigan and local school districts have shared in the responsibility for funding the annual unfunded liability contributions required for both pension and retiree care health benefits. Prior to FY2013, that responsibility fell entirely on districts, which used their foundation allowance dollars to cover the annual assessments. As part of the cost-sharing agreement put in law over a decade ago, the total contribution required from schools is capped at 20.96 percent of a district's annual MPSERS payroll. Required contributions above the district portion come from an annual School Aid Fund (SAF) appropriation. With districts' contributions effectively capped, the state's payment toward the pension and retiree health care unfunded liabilities grew more than tenfold from $161 million in FY2013 to $1.6 billion in FY2024.

With the health care liabilities fully funded as of FY2023 and the statutory floor provision for these debts satisfied, nearly $632 million of the total FY2024 retiree health contributions made by the state and local districts will not be required in FY2025. Recognizing this, the new FY2025 K-12 education budget reduces the state portion of the required annual payment by $632 million. This effectively frees up $632 million of ongoing SAF dollars in the K-12 education budget that can be used for other state priorities next year.

Budget Deal Reduces Districts' Retirement Contributions In Lieu of an Increase to the Foundation Allowance

Final FY2025 state budget negotiations between Senate and House legislative leaders and Governor Whitmer's administration largely centered around how to program the $632 million in freed-up SAF resources currently financing retirement obligations. The Governor's spending proposal, released in February, allocated the funds to address several of her education priorities, notably to expand the state's Great Start Readiness Program to provide no-cost, universal access to preschool and increase student mental health and safety funding. The Senate and House budget proposals took different approaches to programming these resources, instead spreading them across several new and existing programs, including sending some funds directly back to districts and school employees.

In the end, the final K-12 education budget looked very different from any of the three proposals with respect to the use of these funds. In a surprise move to many K-12 stakeholders and budget observers, when the final product was unveiled publicly just hours before a final legislative vote, it was revealed that negotiators agreed to use $598 million of the freed-up funding to reimburse school districts for a portion of their required MPSERS unfunded liability contributions. Effectively, this new reimbursement payment is structured to reduce each district's capped contribution rate from 20.96 percent of payroll to 15.21 percent, for FY2025 only. This move is intended to free up, dollar-for-dollar, funds currently dedicated to paying off legacy retirement debts in districts' budgets next year.

However, because all budget decisions involve trade-offs, the new K-12 spending plan does not increase the per-pupil foundation allowance, the primary state aid source used for schools' general operations. Instead, policymakers agreed to maintain the foundation allowance at the current-year amount of $9,608 per-pupil, relying on the retirement reimbursement payments to take the place of a traditional per-pupil funding increase. In fact, Governor Whitmer and lawmakers are treating the retirement reimbursement payment as equivalent to an average $400 per-pupil foundation increase, noting that this amount is larger than the foundation boosts included in the executive budget ($241 per pupil), the House proposal ($217 per pupil) and the Senate proposal ($302 per-pupil).

But, it is not equivalent in several respects.

The New Retirement Reimbursement is Not the Same as a Foundation Allowance Increase

From a raw dollar standpoint, this new approach is beneficial to most school districts. Nine of 10 traditional public school districts gain more than $302 per pupil in new discretionary funding – which is what they would have received under the most advantageous of three competing spending proposals. And, to be clear, this represents a new stream of discretionary state funding that is entirely separate from the foundation dollars a school receives.

But, while Governor Whitmer and lawmakers claim that the new retirement reimbursements will function like an equivalent increase to the per-pupil foundation allowance, there are notable differences between this funding mechanism and the regular approach to funding annual school operations.

Key among these differences is that the per-pupil amounts will vary considerably across the state's 530-plus traditional school districts. This variation is completely a function of the size of each district's payroll relative to its student enrollment. Generally, two districts with the same student enrollment will see different per-pupil payments based on the size of their respective annual payrolls subject to the MPSERS assessment. The district with a larger payroll will see a larger per-pupil payment because the same retirement contribution rate reduction (5.75 percentage points) is applied to different payroll bases. (Note: Because charter schools are not required to participate in MPSERS, the new state budget provides each school with an equal $375 per-pupil payment in lieu of a regular foundation allowance increase.)

Since FY2022, all schools (traditional public and charter) have received the same annual increase to their foundation allowance. In previous years, annual per-pupil increases varied across districts as lower-funded districts received larger annual bumps to narrow the funding gap with their higher-funded districts. The state equalized the foundation allowance amounts for all districts at $8,700 per pupil in FY2022. Last year (FY2024), all schools received a $458 per pupil increase.

Based on our analysis, the new funding mechanism will result in per-pupil increases next year ranging from less than $20 to more than $2,500 at the extremes, with the statewide average of $402 per pupil. The table below summarizes the different per-pupil funding amounts (e.g., minimum, maximum, and average) across all Michigan school districts, as well as for several salient district groupings.

Estimated Per-Pupil Funding for the $598 Million MPSERS Reimbursement

	All Districts	Low-Poverty Districts	High-Poverty Districts	Largest Districts	Hold Harmless Districts
Minimum	$18	$289	$269	$336	$18
Maximum	$2,583	$654	$584	$654	$2,583
Average	$402	$431	$401	$436	$619

Source: Citizens Research Council analysis based on current-year district payrolls and student counts.

There are noticeable funding variations across districts considered low-poverty (20 percent or lower economically disadvantaged students) and high-poverty (85 percent or greater economically disadvantaged students). While, on average, poorer districts will receive per-pupil payments ($401) equal to that statewide average ($402), wealthier districts are slated to receive payment amounts nearly eight percent greater ($431). Further, there is considerable variation among districts within each of these two poverty-based groupings; some districts will receive more than twice the change in per-pupil funds as others (difference between the minimum and maximum per-pupil amounts).

The $436 average per-pupil payment for the state's largest districts (those with at least 5,000 students enrolled) is about eight percent greater than the statewide average. Again, the funding amounts differ materially as there is nearly a two-times spread between the per-pupil allotments at the two ends of the range for this school grouping.

The average per-pupil allotment will be $619 among the 43 districts commonly referred to as hold harmless districts with the highest foundation allowances (greater than $9,608 per pupil). That is more than 50 percent greater than the $402 average statewide. While this group includes several very small districts (less than 100 students) that are slated to receive funding amounts at the two ends of the range ($18 per pupil and $2,583 per pupil), several larger, well-known districts in this grouping such as Bloomfield Hills Schools and Grosse Pointe Public Schools will see per-pupil reimbursements of $654 and $547, respectively.

As noted above, the differences in per-pupil payments are driven almost entirely by the size of a district's payroll relative to similarly-sized districts. Take for example two large districts with nearly identical K-12 student enrollments (roughly 9,300 students) and similar levels of student poverty (roughly 70 percent economically disadvantaged students). Because Wayne Westland Community School District has a payroll base that is 46 percent larger than that of Kentwood Public Schools, Wayne Westland will get $612 per pupil while Kentwood's allotment will be $414 per pupil.

While it is generally the case that larger districts have larger payrolls, several factors contribute to differences in payroll size even among similarly-sized districts. These include the size and composition of the school workforces, average employee compensation levels, and the amount of non-instructional service out-sourcing a district engages. Districts that contract out different services (food, custodial, student transportation) rather than use their own employees to deliver services have lower payrolls subject to the annual retirement system legacy debt assessments.

Finally, another key difference is the one-time nature of the $598 million SAF appropriation. As previously noted, this will be the first time in over a decade that the state K-12 education budget does not include an increase to the per-pupil foundation allowance. From an ongoing school funding perspective, the annual foundation increase is generally considered permanent and ongoing and can be used by school leaders for both near-term and longer-term fiscal planning. The retirement reimbursement is available for FY2025 only and school officials will be hesitant to factor the funding into their long-term plans unless it is made permanent via a statutory change to reduce MPSERS legacy debt contribution rate (as proposed by Senate Bill 911).

The bottom line is that by maintaining the foundation allowance at the current-year amount ($9,608) in FY2025, the new reimbursement payment does not become part of the ongoing base funding schools receive.

Conclusion

By fully funding the legacy debts of the retiree health care portion of the public school employee pension system, $632 million of current-year fiscal resources are available for other state spending priorities in FY2025. While some Republican legislators called for the freed-up dollars to go towards paying off the $30 billion of unfunded pension obligations, Governor Whitmer and Democrat leaders in both the House and the Senate wanted the money to be used for current spending priorities within the state budget. Meanwhile, a coalition of traditional public school groups called upon state officials to use the available funding to permanently reduce their required MPSERS legacy debt contribution rate from 20.96 to 13.96 percent of payroll and maintain the state's full contribution toward funding these obligations. However, that permanent statutory change is stalled in the legislative process, something that has drawn the ire of many local school leaders and several House Democrats who claim this legislation was part of the final budget deal.

Absent this permanent statutory change, Lansing Democrats approved a K-12 education budget that includes a new $598 million appropriation that is intended to serve two distinct school funding objectives next year, 1) reduce schools' legacy debt funding burden, and 2) provide them with a foundation-equivalent, base funding increase.

In this context, and with a deeper understanding of the practical mechanics of the new funding mechanism, our analysis clearly shows that traditional school districts will receive additional discretionary state funding next year in proportion to their share of the total MPSERS legacy debt. Thus, it appears that the new appropriation will meet policymakers' first funding objective, albeit for one year only.

As for the second funding objective, our analysis shows that the mechanics of this new funding stream will not function as an equivalent increase to the regular per-pupil foundation allowance. While these additional discretionary dollars resemble regular foundation funds from a school budgeting perspective and can be programmed for general school operations, they will not be divided among districts in the same way that districts receive a foundation allowance increase (equal per-pupil amount). That is because the school payroll-based formula used to distribute the $598 million appropriation will result in significant swings in per-pupil funding across districts. As we have noted, some districts will receive more than two times the per-pupil funding of similarly situated districts. And, unlike a base foundation allowance increase, these additional funds are only authorized for one year.

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Craig is the Research Council's Research Director and primary researcher of education and school finance issues. Prior to becoming Research Director, Craig served as the Director of State Affairs and as a Senior Research Associate. During his graduate school studies, he worked for the Council as a Lent Upson-Loren Miller Fellow from 1993 to 1995. Before joining the Council in 2006, Craig worked for ten years as a fiscal analyst at both the Senate Fiscal Agency and the House Fiscal Agency. He previously worked for the Michigan Department of State, Office of Policy and Planning and the United States Environmental Protection Agency in Chicago.

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