State Budget Notes

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School Aid Budget: Will FY2014 Increases Be Sustainable in FY2015?

Just nine days following the announcement of an agreement on state budget targets, the Legislature wrapped up the first large piece of the Fiscal Year (FY) 2014 state budget when it sent the omnibus budget bill containing FY2014 appropriations for K-12 schools, universities, and community colleges to the Governor.[1]

Funding for K-12 school districts included an additional $126.6 million above the level initially recommended by the Governor – the result of May revenue estimates that included a cumulative $123.3 million in additional School Aid Fund revenue across both FY2013 and FY2014.

The additional revenue allows for enhancements to the budget that result in small per-pupil funding increases for all school districts, but the magnitude of the increases varies significantly across districts. The inclusion of an equity payment means that districts currently receiving the minimum foundation allowance will see larger increases than districts receiving more than the minimum allowance. Further, changes to funding earmarked to assist districts with retirement obligations will be more advantageous to the 84 percent of all charter schools that do not rely on that funding to finance Michigan Public School Employee Retirement System (MPSERS) contributions.

Unfortunately for school districts, projected School Aid Fund revenues for FY2015 may not be adequate to maintain these budgeted increases. Since much of the new revenue identified at the May consensus conference was tied to circumstances unique to FY2013, the short-term bump in available revenues is significantly larger than the long-term projected increase for FY2015 and beyond. Without either an increase in the GF/GP contribution for the School Aid budget or some further improvement in projected School Aid revenues, a significant portion of the FY2014 budgeted increases will need to be eliminated in FY2015. State policymakers will be faced with another round of difficult decisions next year in finding a balance between maintaining these increases for school districts, meeting other state GF/GP funding needs, and making decisions on funding for early childhood education, with the Governor having requested an additional $65.0 million of School Aid Fund revenue in FY2015 for the Great Start Readiness Program in his February proposal.

May Revenue Consensus: How Were New School Aid Revenues Allocated?

School districts received good news following the recent May consensus revenue estimating conference. School Aid Fund revenue projections for FY2013 came in $85.3 million higher than the January forecast on which the FY2013 budget is based. The increased estimate was driven by a sharp increase in projected personal income tax revenue contributions to the SAF, which were $110.3 million above January estimates. This helped offset a net decline in revenues from other sources. State economists theorize that the additional income tax receipts are the result of individuals taking capital gains in tax year 2012 as protection against the potential for higher federal capital gains tax rates that were scheduled to become effective with the onset of the "fiscal cliff" at the end of 2012.[2]

[1] House Bill 4228 was signed by Governor Snyder on June 13, 2013 with no vetoes. See http://legislature.mi.gov/doc.aspx?2013-HB-4228.

[2] The eventual resolution of the "fiscal cliff" deliberations resulted in the federal capital gains tax rate rising from 15 percent to 20 percent, but only for families with annual incomes above $450,000 and individuals with annual incomes above $400,000

Table 1
Changes in Consensus Revenue and Cost Projections, January to May
(Dollars in Millions)

	FY2013	FY 2014	FY2015
School Aid Fund Revenue			
January 2013 consensus	$11,127.7	$11,432.5	$11,768.8
May 2013 consensus	$11,213.4	$11,470.1	$11,812.7
Increase/(Decrease) from January 2013	**$85.7**	**$37.6**	**$43.9**
K-12 Cost Adjustments			
New savings from May consensus	$5.1	$33.0	$50.5
Combined Increase/(Decrease) from January 2013	**$90.8**	**$70.6**	**$94.4**

Without the benefit of this additional one-time revenue related to capital gains, upgrades to School Aid Fund revenue projections were somewhat smaller in future years with an additional $37.6 million estimated for FY2014 and $43.9 million for FY2015.

In addition to the improved revenue picture, downward revisions to statewide pupil estimates and upward revisions to expected contributions from local property taxes both reduced expected state costs from School Aid Fund revenues, which also freed up new resources. **Table 1** outlines the School Aid-related changes in revenue and cost assumptions from the last January 2013 revenue consensus.

Table 2
Summary of Enacted Changes to Governor's K-12 Budget, 2013
(Dollars in thousands)

	Executive Budget	Enacted Budget	Change from Executive
Increases for Districts			
Foundation allowance increase	$0.0	$75,700.0	$75,700.0
One-time equity payment	$24,000.0	$36,000.0	$12,000.0
Hold harmless payments	$0.0	$6,000.0	$6,000.0
Fully fund district performance grants	$0.0	$16,400.0	$16,400.0
Other funding increases	$0.0	$3,826.6	$3,826.6
Subtotals	**$24,000.0**	**$137,926.6**	**$113,926.6**
Restoring Executive-Proposed Reductions			
Best practices incentive grants	($55,000.0)	$0.0	$55,000.0
Technology infrastructure improvement grants	($36,500.0)	$0.0	$36,500.0
Consolidation innovation grants	($10,000.0)	($5,000.0)	$5,000.0
Subtotals	**($101,500.0)**	**($5,000.0)**	**$96,500.0**
MPSERS Cost Offset Reduction	**$0.0**	**($55,000.0)**	**($55,000.0)**
Other Adjustments and Earmarks	**$10,216.7**	**($18,641.1)**	**($28,857.8)**
Total Enacted Changes			**$126,568.8**

With these extra resources in hand, state policymakers were faced with decisions as to how to allocate the new revenue. **Table 2** reviews these decisions, comparing the enacted changes in the K-12 budget with the Governor's original February recommendation. The enacted budget includes $113.9 million in new funding that should broadly affect all districts. It also allocates $96.5 million to restore funding reductions proposed by the Governor to major categorical programs. Together, these funding enhancements add $210.4 million for school districts. This new funding is offset, however, by a $55.0 million reduction in categorical funding to help cover district retirement liabilities under the Michigan Public School Employees Retirement System (MPSERS). Net cost savings of $28.9 million from other adjustments (primarily the projected consensus savings) bring in the overall budget at $126.6 million over the original Governor's recommendation.

Funding Increases for Districts

The enacted budget includes $75.7 million to finance an increase in both the basic and minimum foundation allowances for school districts. Districts that received the minimum foundation allowance of $6,966 per pupil in FY2013 will see their grant increase by $60 per pupil to $7,026 in FY2014. Districts that received an allowance at or above the basic foundation grant level of $8,019 will see an increase of $30 per pupil, with the basic foundation allowance rising to $8,049. Districts between the minimum and basic grant levels will have their increases determined on a sliding scale through the K-12 "2x formula". These increases will range between $40 and $60 per pupil, with greater increases for districts with foundation allowances near the minimum level.

The budget also includes $36.0 million to finance an equity grant payment of up to $50 per pupil for districts at or very near the minimum foundation allowance, which will supplement the $60 bump to their foundation allowances. Another $16.4 million is added to fully fund district performance grants which are tied to improvements in student proficiency as measured by state standardized testing. Districts can earn up to $100 per pupil in performance grant funding: $30 per pupil based on grades 3-8 mathematics testing, $30 per pupil based on grades 3-8 reading testing, and $40 per pupil based on overall high school testing. Current appropriations were not sufficient to cover estimated disbursements under the program. Without the additional funding, these grant amounts would have needed to be prorated.

Restoring Executive-Proposed Reductions

In addition to the new funding, the enacted budget rejected a number of funding reductions included in the Governor's February proposal. First, the Legislature rejected a recommended reduction of $55.0 million in Best Practices Incentive grant funding provided to districts that meet 7 out of 8 best practices criteria outlined in the appropriation bill. This would have reduced per-pupil funding to qualifying districts from $52 in FY2013 to $16 in FY2014. A joint House Fiscal Agency-Senate Fiscal Agency budget document suggests that 578 of the state's 820 districts (70.5 percent of the all traditional districts and charters) will receive funding under the program in FY2014.[3]

The enacted budget also restored $36.5 million for Technology Infrastructure Improvement grants, a competitive grant program that provides funding for technology infrastructure improvements in preparation for the planned implementation of online growth assessments in FY2015. However, $5.0 million of the restored funding was earmarked for a competitively-bid contract with a single

[3] House Fiscal Agency and Senate Fiscal Agency, *FY 2013-14 School Aid Budget - Estimated District Impact*

provider of "whole-school technology." Thus, slightly less would be available for direct support to districts. Finally, the budget retained $5.0 million for Consolidation Innovation grants to assist districts with transition costs related to district or intermediate school district consolidations. The FY2013 budget contained $10.0 million for this purpose; the Governor had proposed eliminating the funding for FY2014.

MPSERS Cost Offset Reduction

While the Legislature rejected a number of the Governor's proposed reductions, it helped pay for the restorations and other new funding enhancements by reducing a categorical grant aimed at helping districts cover Michigan Public School Employees Retirement System (MPSERS) retirement system costs. Beginning in FY2012, a $155.0 million MPSERS Cost Offset categorical grant was established to assist districts in meeting these escalating costs that arose largely from the financial market turmoil in 2008 and 2009.[4] The enacted budget reduces this allocation by $55.0 million, the same amount that was shifted into the restoration of Best Practices grant funding. The shift has significant consequences for some districts. Most charter schools, for instance, do not pay into the MPSERS. Thus, the loss of the retirement cost offset has no impact on them. On the other side, districts that do not qualify for Best Practices funding (242 of 820 districts did not qualify in FY2013) but that do participate in MPSERS may gain nothing in their base budgets from the Best Practices restoration but lose funding under the reduced MPSERS Cost Offset allocation.

Hold Harmless Funding

The shifts in categorical funding levels created winners and losers among school districts in the original conference report brought before conferees for consideration. As noted above, charter schools with no MPSERS obligations will see increases in their foundation grants (and sometimes an additional equity payment as well) without losing anything from the reduced MPSERS categorical. At the same time, the $30 per pupil foundation increase included for districts at or above the basic foundation grant level typically is insufficient to make up for the loss incurred from the MPSERS Cost Offset reduction. An analysis by the legislative fiscal agencies suggests that 66 districts would have seen net per-pupil revenues fall from FY2013 levels under that original proposal.[5]

In order to ensure that all districts saw an overall net increase of at least $5 per pupil from their FY2013 base funding level, the conference report was amended during committee deliberations to allocate $6.0 million in hold harmless funding. Revenue to finance the amendment was taken from the MPSERS Reserve Fund established to support transition costs for retirement system reforms. The funding will essentially fill in any hole for those districts that stood to lose significantly from the reduction in the MPSERS Cost Offset allocation. Primarily, this funding helps traditional K-12 districts with relatively high FY2013 foundation allowances (and thus relatively low FY2014 foundation increases under the "2x formula") and relatively high per-pupil payroll costs (and thus relatively high reductions resulting from the cut to the MPSERS Cost Offset allocation).

[4] These escalating costs and their impact on district finances were the focus of a recent CRC State Budget Note, *Public Education: The Recent Impact of Increased MPSERS Contributions*, www.crcmich.org/PUBLICAT/2010s/2013/sbn2013-01.pdf

[5] For this purpose, the net per-pupil revenue increase counts only new unrestricted funding. It does not include new categorical funding to cover increased MPSERS costs above a new statutorily-established employer cap. These revenues are allocated to meet expected MPSERS cost increases and thus will not be available for general operations.

Impact of Budget Changes on Individual Districts

While the average school district statewide will receive a $60 increase in net per-pupil revenues under the new budget, the impact of the budget on individual districts will vary widely for the reasons cited above. The House Fiscal Agency and Senate Fiscal Agency collaborated on a district-by-district impact report[6] that analyzes the financial implications of these changes for individual districts. **Table 3** summarizes these outcomes for school districts and compares outcomes for:

- Traditional K-12 districts and charter schools
- Districts at the minimum foundation and above the minimum foundation
- Among charter schools, those with and without MPSERS-related costs

The 377 traditional K-12 school districts that receive the minimum foundation allowance in FY2013 will receive an average net per-pupil increase of $75 per pupil (equivalent to a 1.1 percent increase in their foundation allowance).[7] They each receive the maximum $60 per pupil increase in their foundation grants along with the maximum $50 per pupil one-time equity payment. Conversely, these districts will lose an average $35 per pupil from the redirection of $55.0 million from the MPSERS Cost Offset allocation.

The 169 traditional districts that receive more than the minimum foundation grant in FY2013 will see a significantly smaller average net increase of $12 per pupil (equivalent to a 0.2 percent increase to the average foundation grant for this group). The average boost to the foundation for these districts will be only $46 per pupil under the K-12 formula. This will be almost exactly offset by the average reduction of $46 per pupil from the MPSERS funding reallocation. Only seven of the districts (those very close to the minimum foundation grant) will receive a boost from the equity payments. However, the hold harmless funding provided in the conference amendment will have its impact here with 78 districts receiving allocations to provide them the minimum $5 per pupil net increase. Without the new funding, the average net increase for this group as a whole would be near zero, with most of the 78 hold harmless districts losing in terms of net per-pupil funding.

Charter schools will fare somewhat better under the plan, primarily because most are insulated from the impact of the MPSERS Cost Offset redirection. The biggest winners are the 53 charter schools that receive the minimum foundation grant and have no MPSERS obligations. All

[6] House Fiscal Agency and Senate Fiscal Agency, *FY 2013-14 School Aid Budget - Estimated District Impact*

[7] Again, the net increase figures here exclude the increase in state funding allocated specifically to cover increased MPSERS retirement costs.

Table 3
Average Net Increases to K-12 School Districts under 2013 Enacted Budget

	Total Count	Equity Count	HH Count	Average FY2013 Foundation	Average Per-Pupil Change: Foundation Increase	Equity Payment	MPSERS Reduction	Hold Harmless	Average Net Increase
Traditional K-12 Districts									
Minimum foundation in FY13	377	377	0	$6,966	$60	$50	($35)	$0	$75
Above minimum foundation in FY13	169	7	78	$7,946	$46	$1	($46)	$12	$12
Public School Academies									
Minimum foundation/with MPSERS impact	15	15	0	$6,966	$60	$50	($28)	$0	$82
Minimum foundation/no MPSERS	53	53	0	$6,966	$60	$50	$0	$0	$110
Above minimum/with MPSERS impact	32	2	0	$7,098	$58	$3	($16)	$0	$45
Above minimum/no MPSERS	173	7	0	$7,096	$58	$1	$0	$0	$59
Education Achievement Authority	1	0	0	$7,190	$56	$0	$0	$0	$56
All Districts Combined	820	461	78	$7,201	$57	$28	($27)	$3	$60

Source: CRC calculations from House Fiscal Agency/Senate Fiscal Agency district-by-district impact report

53 charters in this category receive a net increase of $110 per pupil – receiving the full $60 per pupil foundation increase and the full $50 per pupil one-time equity funding. Unlike their traditional K-12 district counterparts, these charter schools had no offsetting losses from the $55.0 million redirection of retirement funding. The 15 other charters that receive the minimum foundation grant but do participate in MPSERS will see an average net increase of $82 per pupil – just slightly above the average increase for traditional districts in the same situation.

Charter schools receiving above the minimum foundation grant will fare slightly better than traditional K-12 school districts in the same category. Because the foundation allowance for charter schools is capped at $7,110,[7] these charters will receive an average increase of $58 per pupil in the foundation allowance under the funding formula. Further only 32 of the 205 charter schools receiving foundation grants above the minimum have MPSERS retirement obligations and thus are impacted by the funding redirection. The average net increase for these charter schools was $59 per pupil for those with no MPSERS obligation and $45 per pupil for those that were impacted by the MPSERS funding reduction.

Looking to FY2015: What Can Be Sustained?

Unfortunately for school districts, FY2014's gain may not sustainable in FY2015. Given that the bulk of the newly available SAF revenue identified at the May revenue consensus conference came from unusually high income tax collections tied specifically to FY2013, the extra revenue that allowed for the foundation allowance increase, the equity payment increase, and some of the funding restorations will not be available in FY2015. **Table 4** reviews projected SAF revenues and expenditures for FY2014 to estimate this potential shortfall.

The increase in projected revenues and decreased costs for FY2013 that were identified in the May consensus conference will help bolster the School Aid Fund balance available at the beginning of FY2014. Combining the new revenues and cost adjustments, the SAF should have a beginning balance of around $140.7 million for FY2014.

Total SAF revenues for FY2014, including the additional $37.6 million projected at the consensus conference, should total just over $13,620.5 million. With $13,361.8 million appropriated for K-12 school districts and another $398.1 million in School Aid Fund contributions for universities and

[7] By comparison, the average foundation allowance for traditional K-12 districts with allowances above the minimum grant level was $7,946.

Escrowed Employee Contributions for Retiree Health Care

One major unknown for school revenues is the eventual disposition of an estimated $508.0 million generated through a three percent employee contribution for retiree health care benefits originally imposed in MPSERS retirement reform legislation enacted in 2010 and collected prior to the implementation of subsequent legislative changes enacted in 2012. In August 2012, the Michigan Court of Appeals affirmed that the three percent charge was unconstitutional and the case currently awaits a review by the State Supreme Court. If the Court reverses the Court of Appeals decision and rules that the three percent contribution was lawful, these escrowed funds could be available for appropriation in FY2015 and would be more than enough to make up the one-year shortfall. However, if the Supreme Court ultimately affirms the appellate court's ruling and returns the escrowed funds to employees, the escrowed funds would clearly not be available to address the shortfall.

Barring a favorable court ruling or significant improvements in SAF revenue projections, state policymakers will have to rely on additional GF/GP or other revenue support to maintain current appropriations.

community colleges, total appropriations will exceed total revenue for FY2014. As a result, the School Aid Fund beginning balance will largely be used up during the year, leaving a small estimated balance of around $1.3 million at FY2014 book closing.

Looking ahead to FY2015, new structural problems arise. In addition to utilizing an estimated $139.4 million of the existing SAF balance, the FY2014 budget also calls for the utilization of $156.0 million from the MPSERS Reserve Fund, leaving only an $18.0 million balance in this fund for FY2015. When combined, the available balances from the two funds support $295.4 million in FY2014 appropriations. However, their remaining balances are estimated to total only $19.3 million at the beginning of FY2015. That means $276.1 million in one-time resources from the two funds will no longer be available to support spending in FY2015.

The May consensus revenue conference forecast fairly healthy revenue growth in the School Aid Fund for FY2015, with total revenues expected to exceed FY2014 levels by $342.6 million. But after accounting for the declines in one-time revenue, that leaves only $65.2 million in new revenue left over to support any new spending needs.

In addition, the Governor's FY2014 budget proposal already forecast the need for $310.9 million in additional spending for FY2015 tied to two budget items. The largest of these is continued increases in the amount needed to cover MPSERS unfunded liabilities. Recent reforms to the retirement system cap employer contributions coming out of school district budgets and provide direct state SAF appropriations to cover any amounts exceeding the new cap. As of

Table 4
School Aid Fund Projected Revenues and Expenditures, FY2014 and FY2015
(Dollars in Millions)

	FY2014	FY2015
Estimated Beginning Balance - February 2013	**$49.9**	
Additional FY2013 Revenues - May Consensus	85.7	
Cost Adjustments/Supplementals since January	5.1	
New Estimated Beginning Balance	**$140.7**	**$1.3**
Revenues		
January 2013 Consensus SAF Revenues	$11,432.5	$11,768.8
Additional Revenues - May 2013 Consensus	37.6	43.9
GF/GP Contribution to K-12	230.0	230.0
MPSERS Reserve Fund	156.0	18.0
Federal Revenue	1,764.4	1,764.4
Total Adjusted Revenues	**$13,620.5**	**$13,825.1**
Expenditures		
FY2014 K-12 Appropriations	$13,361.8	$13,361.8
Additional MPSERS costs above employer cap		245.9
Great Start Readiness Program		65.0
Other Estimated FY2015 Cost Adjustments		(6.9)
FY2014 SAF - Universities/Community Colleges	398.1	398.1
Total Expenditures	**$13,759.9**	**$14,063.9**
Estimated Ending Balance	**$1.3**	**($238.8)**

Source: CRC calculations based on analysis of Senate Fiscal Agency and House Fiscal Agency budget documents

February, it was projected that an additional $245.9 million would be needed to finance the additional MPSERS costs above the cap for FY2015. Further, the Governor had proposed a second $65.0 million increase in FY2015 funding for the Great Start Readiness Program (GSRP) to finance the expansion of pre-kindergarten programs. This funding would further add to FY2015 School Aid Fund expenditures if that proposal is implemented during the next budget cycle.

Table 4 reviews the status of the School Aid Fund for FY2015 under the following assumptions: (a) GF/GP support for the K-12 budget remains at $230.0 million; (b) the remaining $18.0 million balance in the MPSERS Reserve Fund is appropriated in FY2015; (c) the additional proposed spending for both MPSERS and GSRP is implemented; and (d) SAF support for universities and community colleges is maintained at current levels. Under this scenario, projected expenditures exceed projected resources by around $238.8 million. Even if the additional increase for GSRP is not implemented in FY2015, the shortfall would remain at an estimated $173.8 million.

Without added resources, significant reductions will be needed from existing K-12 appropriations in order to cover this shortfall. As noted earlier, the Legislature utilized $210.4 million in the FY2014 budget to provide funding increases and restore Executive-proposed reductions. The elimination of all of these revisions may still not be sufficient to cover the projected shortfall should the Governor's second-round increase for the Great Start Readiness Program be implemented during the next budget cycle.