



STATE BAILOUTS TO ERASE SCHOOL DISTRICT ACCUMULATED DEFICITS

The emergency manager of the fiscally distressed Muskegon Heights School District has developed a proposal to head off bankruptcy that would redirect a dedicated local millage intended to finance school operations and instead use the tax to eliminate the outstanding debts and legacy costs in one of the state's most urban and property poor school districts. If accepted, the proposal would result in fewer state dollars for less fiscally challenged local schools so that a single district could receive additional state aid to address its financial problems and get out from under the burdens created by chronic operating deficits. This plan, effectively a state bailout, is being pursued without the direct involvement of the Michigan legislature or a separate state appropriation. While it is entirely possible that a state bailout is the preferred option, this is not transparent nor is it the product of a broader consistent state policy concerning financially distressed school districts.

Background

Beginning in the fall of 2012, the financial and operating plan offered by the emergency manager for the Muskegon Heights School District would end direct educational services provided by the District and instead have services provided by a charter school operator hired by the emergency manager, acting in lieu of the Muskegon Heights School District's elected school board and appointed superintendent. Most recently, the emergency manager appointed to run Highland Park City Schools indicated that she would pursue the same alternative beginning this fall. In both cases, the local dedicated school operating tax that is part of the per-pupil foundation grant will be redirected to finance the districts' accumulated deficits. Additional state dollars will be provided to the charter school in place of these "lost" local operating funds to keep whole the districts' foundation grants and avoid gutting the educational programs offered.

Notwithstanding consideration of whether the charter school model is a better fit than the traditional local school district model for educating students in the 21st Century, Muskegon Heights' plan is a financial solution to a chronic fiscal problem that the district has been unable to solve. The solution hinges on the provision of additional state funds. The opportunity to maintain school operating funding and, at the same time, erase the accumulated deficit is made possible by the interaction of Public Act 4 of 2011 and the school finance system that was put in place with the adoption of Proposal A of 1994. Specifically, the unilateral decision by the emergency manager to charter an entire school district combined with the financing mechanisms for the per-pupil foundation grant serve as the vehicles to provide a state bailout. Both the conversion of the entire district to a charter school and the attendant increase in state funds that comes with the new foundation grant occurs without state legislative deliberations or actions.

The Foundation Grant

A foundation grant system provides designated per-pupil funding amounts to each school district from a combination of local and state funding sources. In Michigan, each school district is expected to levy an 18-mill school operating property tax (see below) to apply towards its foundation grant. The amount of the per-pupil grant varies across districts and is set annually by the Michigan legislature. Although the 18-mill tax is considered a local tax, it is mandatory for all practical purposes and is as much a part of the school funding system as the state levied sales tax, cigarette tax, and 6-mill State Education Tax. Depending on the property wealth in each school district, the tax generates varying amounts of funding. The total tax levy is divided by the number of students, to arrive at a per-pupil local share for each district's foundation grant. Sufficient School Aid Fund dollars are then provided to "top off" each district's foundation grant.



State policymakers set the amount of the foundation grant for each district annually. A number of factors go into the determination of the year-over-year changes in per-pupil funding available to each district. The total amount of funding available from the various sources (revenues from state and local property taxes, sales and use taxes, cigarette taxes, etc.) varies with annual fluctuations in economic activity. The total number of students in the public school sys-

tem changes with demographic shifts. In addition to these independent variables, state policymakers control several dependent variables such as plans to funnel greater funding to the lowest per-pupil revenue districts to equalize spending across districts (bringing the bottom districts up), or decisions to divert funding into categorical funding programs (for transportation, specific academic programs, or other costs incidental to school district operations).

Authorization to Levy the 18 Mills

The Revised School Code (Public Act 451 of 1976, as amended) provides the boards of traditional school districts with the authority to levy not more than 18 mills for “school operating purposes” or the number of mills levied in 1993 for such purposes, whichever is less. Personal residence, qualified agricultural property, industrial personal property, and certain other types of property are completely exempt from the tax and commercial personal property is exempt from 12 of the 18 mills. Generally speaking, the remaining real and personal property subject to the tax is considered “non-homestead” (mainly business and second homes). The millage must be approved by the electors of the school district and is subject to the automatic rate rollback provisions of the Headlee Amendment (Article IX, Section 31) to the Michigan Constitution (for the purposes of calculating the state’s contribution to a district’s foundation grant, it is assumed that a district is levying the entire 18 mills).

Public Act 4 of 2011 grants broad powers to an emergency manager. Under the act, the emergency manager is granted the authority to act for and in the place and stead of a local school board and the district’s superintendent. Also, the emergency manager has the power to exercise solely, on behalf of the school district, all authority and responsibilities prescribed by law to the school board or superintendent. Therefore, Public Act 4 effectively transfers the power to levy the 18-mill tax from the elected local school board to the emergency manager. An emergency manager cannot increase tax rates or impose new taxes without a vote of the people, but he or she may place a proposal for a tax increase on the ballot at a general November election. Current authorization to levy the 18-mill school operating tax in the Muskegon Heights School District was last approved by the voters in May 2008 and is scheduled to expire in December 2013. The tax raises approximately \$1.2 million. Therefore, the reauthorization vote will have to occur at the November 2012 election.

The Muskegon Heights School District emergency manager plans to continue to levy the 18-mill tax. However, the proceeds would be redirected solely to finance the accumulated deficit of the district, as opposed to paying for “school operating purposes”, including educational services for students. It remains open whether paying down an accumulated deficit of a school district is consistent with the meaning of “school operating purposes”. The Revised School Code includes “deficiencies in operating expense for *the preceding year* (emphasis added)” in the statutory definition of “school operating purposes”, but makes no mention of using the 18-mill tax for the purposes of satisfying a multi-year, accumulated deficit.

CRC BOARD OF DIRECTORS

JEFFREY D. BERGERON, Chair
 TERENCE M. DONNELLY, Vice Chair
 ALEKSANDRA A. MIZIOLEK, Treasurer
 MICHAEL G. BICKERS
 BETH CHAPPELL
 MARK A. DAVIDOFF
 RANDALL W. EBERTS

DAVID O. EGNER
 LAURA FOURNIER
 EUGENE A. GARGARO, JR.
 JOHN J. GASPAROVIC
 INGRID A. GREGG
 MARYBETH S. HOWE
 NICK A. KHOURI

DANIEL T. LIS
 SARAH L. MCCLELLAND
 MICHAEL P. MCGEE
 JIM MURRAY
 CATHY NASH
 PAUL R. OBERMEYER
 BRIAN PETERS

KEVIN PROKOP
 LYNDIA ROSSI
 JERRY E. RUSH
 MICHAEL A. SEMANCO
 TERENCE A. THOMAS, SR.
 KENT J. VANA
 THEODORE J. VOGEL

CRC MEMORANDUM

Charter schools are public schools (they are open to all who wish to enroll and may not charge tuition to supplement the public funding) that operate with private school models. Charters may be granted by the state's public universities, community colleges, intermediate school districts, or traditional public school districts. Students may apply for admission to any charter school regardless of geographic location and acceptance is subject only to the space available (lotteries must be used to provide acceptance if applications exceed the number of slots available). Like their traditional public school counterparts, charter schools also receive the bulk of their operating revenues through a per-pupil foundation grant. However, because charter schools do not have defined geographic boundaries and do not have property value upon which to levy a property tax (or the authority to levy such taxes), they are dependent on state funding for their operating revenues (notwithstanding some federal funding). In other words, the per-pupil foundation grant that a charter school receives is wholly financed by the School Aid Fund.

A number of actions can shift a greater percentage of the burden for funding school operations from local school districts to the state and the School Aid Fund. Property tax abatements reduce the amount

of property tax base upon which school taxes (local 18-mill tax and 6-mill State Education Tax) are levied. Likewise, the cessation of all school district operations by an individual school district to be replaced by charter school operators shifts the funding responsibility to the statewide school funding pot. For every local 18-mill tax dollar removed from a district's per-pupil foundation grant, the state School Aid Fund has to add one dollar (holding the foundation grant constant.)

This is the plan for the Muskegon Heights School District: remove the local tax dollars for the foundation grant and replace them, dollar-for-dollar, with funds from the School Aid Fund. The additional state funds being provided to Muskegon Heights under this proposal mean that less funds will be available for all other school districts in the state. The district profile presented here illustrates how this plays out, using figures (taxable value, foundation grant, and enrollment) that approximate the current situation in Muskegon Heights School District. Under the charter conversion, the School Aid Fund will be providing Muskegon Heights School District with an estimated additional \$840,000 per year (\$600 per pupil), resources that will not be available for other districts in the state.

District Profile

Foundation grant: \$7,397
 Number of students: 1,400
 Local 18-mill tax: \$1.2 million

	<u>Traditional Public School</u>	<u>Charter School</u>
18-mill tax (per pupil)	$\$1.2 \text{ million} / 1,400 = \887	NA
State aid (per pupil)	$\$7,397 - \$887 = \$6,510$	\$7,110*
Total state share of foundation grant	$\$6,510 * 1,400 = \$9,114,000$	$\$7,110 * 1,400 = \$9,954,000$
Difference		\$840,000

Who bears the cost?

The proposed changes in operating structure for the Muskegon Heights School District have clear financial advantages for the district. Locally levied operating taxes will no longer be used to contribute to the foundation grant and will instead be used solely to retire outstanding debt that has been incurred over the years to finance deficit spending. The new Muskegon Heights Public School Academy System, the charter school responsible for providing educational services, will receive all of its operating funding from a foundation grant that is 100 percent financed by the state's School Aid Fund. Also, the Muskegon Heights School District is eligible to charge up to 3 percent of the state aid received by the new charter school to cover administrative and oversight costs.

Under this plan, the proceeds from the 18-mill school operating tax are being completely removed from financing the foundation grant for any student, either traditional public or charter school. When traditional public school districts charter individual schools within their district, the 18-mill tax is still collected and used to finance the foundation grants of the remaining students attending the other schools within the district. This changes the cost-share between the local 18-mill tax and state aid for financing the foundation grant for students remaining in the traditional public school district; however, the state's overall financial outlay does not change materially. In the case of Muskegon Heights School District, there are no students remaining to receive a foundation grant as all of them will be attending the Muskegon Heights Public School Academy System where the School Aid Fund is forced to pick up 100 percent of the financing costs of these students' foundation grants.

The academic staff (even if they are the same teachers that currently serve in the district and are rehired to teach in the charter school) will be employees of the charter operator and not the school district. As such, these employees likely will not be members of the state-administered Michigan Pub-

lic School Employees' Retirement System (MPSERS), which provides pension and retiree health benefits. If the employees are not members of the MPSERS, the charter operator will not be required to contribute to the system to pay for normal costs of pension benefits, the costs of current retiree health care (financed on a cash basis), or the unfunded liabilities of the pension benefits. Although the operator may provide these benefits on its own (e.g., 401(k) retirement plan), the cost of doing so is likely to be much lower than the required employer contribution to MPSERS, which is scheduled to be 27.4 percent of school district payroll for the upcoming school year. As a result, more of the charter district's operating funds will be spent for current costs, as opposed to the legacy costs for current or future retirees.

Also, all of the unfunded costs that former employees of the Muskegon Heights School District incurred as a result of being members of MPSERS will have to be paid (assuming the school employees hired by the charter operator are not members of the system). These costs will be borne by the remaining members (and school districts) participating in MPSERS. Therefore, the required employer contribution rate will increase in future years for all remaining districts, assuming a constant payroll base.

Essentially, the proposed changes allow the Muskegon Heights School District to keep the taxes levied for school operations for their own needs. The changes shift school operating costs to the balance of the state to either raise taxes on behalf of the district or shrink the overall amount of the funding pie to be split amongst the existing students and school districts throughout the state. Also, the Muskegon Heights School District, as the charter school authorizer for the new Muskegon Heights Public School Academy System, will be able to charge and retain the state maximum 3 percent authorizer fee. This fee is levied on the total state aid received by the charter school (foundation grant and categorical grants) and is intended to cover the costs associated with the authorizer's administrative and oversight responsibilities.

What is the end game?

Both school districts (Muskegon Heights and Highland Park) are located in urban parts of the state that have suffered from massive public and private disinvestment over the years. Both of these school districts are relatively small in geographic size (2.98 square miles). Both have had declining student enrollments for years as families have departed and students have used school choice to attend neighboring school districts or established charter schools.

It leaves one to wonder what will become of these school districts in five, ten, or twenty years. Will they exist solely to serve as the authorizing entities for charter schools? How long will residents of these districts agree to pay the school operating taxes when no schools are being operated by the districts directly? What happens to the 18-mill tax when the accumulated deficits are paid off? If, at some point the charter is revoked or there is no qualified applicant to run the schools, who will resume school operations, and how will they attract students back to their schools?

The announced end of school operations really begs the question of whether these school districts are big enough in geographic size or student counts to warrant their existence. Michigan has many school districts that are relatively small in size or number of students, or both. State policymakers have been pushing for intergovernmental collaboration, service sharing, and consolidation among all types of local governments, school districts included. With the current mammoth deficits and student performance factors that have plagued them, neither Muskegon Heights nor Highland Park have been prime partners for consolidation efforts with nearby districts. However, if the state government is effectively paying down their accumulated deficits, thus removing one of the primary obstacles to consolidation efforts, should these districts be candidates for state-mandated consolidation with neighboring districts?

As two of the most financially troubled school districts in the state, Muskegon Heights and Highland Park may be the canaries in the coal mine, signaling troubles to come for many of the other districts fac-

ing similar financial difficulties. As of June 30, 2011, 41 traditional public school districts had operating deficits. Should all of these districts be turned over to an appointed emergency manager and then converted to charter schools similar to what is being proposed in Muskegon Heights, the state's financial exposure would be considerable. For example, the much larger Detroit Public Schools, which is already under the control of an emergency manager, had a \$284 million deficit as of June 30, 2011. Detroit's local 18-mill tax currently generates \$87 million toward its foundation grant. Are the state and all other school districts in Michigan willing to accept these potential costs if other districts follow the Muskegon Heights School District example?

At this juncture, a key question must be addressed: Is the proposal for Muskegon Heights the new state model for dealing with financially troubled school districts? Currently, the state lacks a consistent state policy for the provision of additional state resources to financially distressed school districts that have been unable to solve their problems on their own. To this point, the state has been reticent to offer additional state funds to school districts that remain within the traditional public model to help them manage their finances. Public Act 4 is designed to remove the financial authority from traditional decision makers and concentrate authority in a single person with broad powers. One option available to the emergency manager appears to be a state bailout contingent on converting the district to the charter school model. Is this option available to all traditional districts under an emergency manager (or to financially troubled districts not operating under PA 4)?

Ignoring the fact that the state lacks a consistent policy on the matter, a state bailout is being provided without the input of the Michigan legislature or an additional appropriation. Instead, the additional state funds are the result of the unique interaction of the powers granted to the emergency manager under Public Act 4 and the architecture of the per-pupil foundation grant. At a minimum, if the state is signaling its willingness to absorb the debt of failing school districts, it should do so in an overt manner rather than the less than overt approach that is being proposed.