

# Analyzing the Governor's FY2025 Budget Recommendations

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Citizens Research Council of Michigan

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- Statewide
- Non-partisan
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- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions from Michigan foundations, businesses, and individuals
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# Robert Schneider, Senior Research Associate



- Work Experience
  - 2<sup>nd</sup> period with Citizens Research Council
  - State Budget Office
  - House Fiscal Agency
- Policy Background
  - State budget
  - Human Services
  - Corrections
  - Transportation
- Education
  - B.S. in Economics from Central Michigan University
  - M.A. in Economics from Michigan State University.

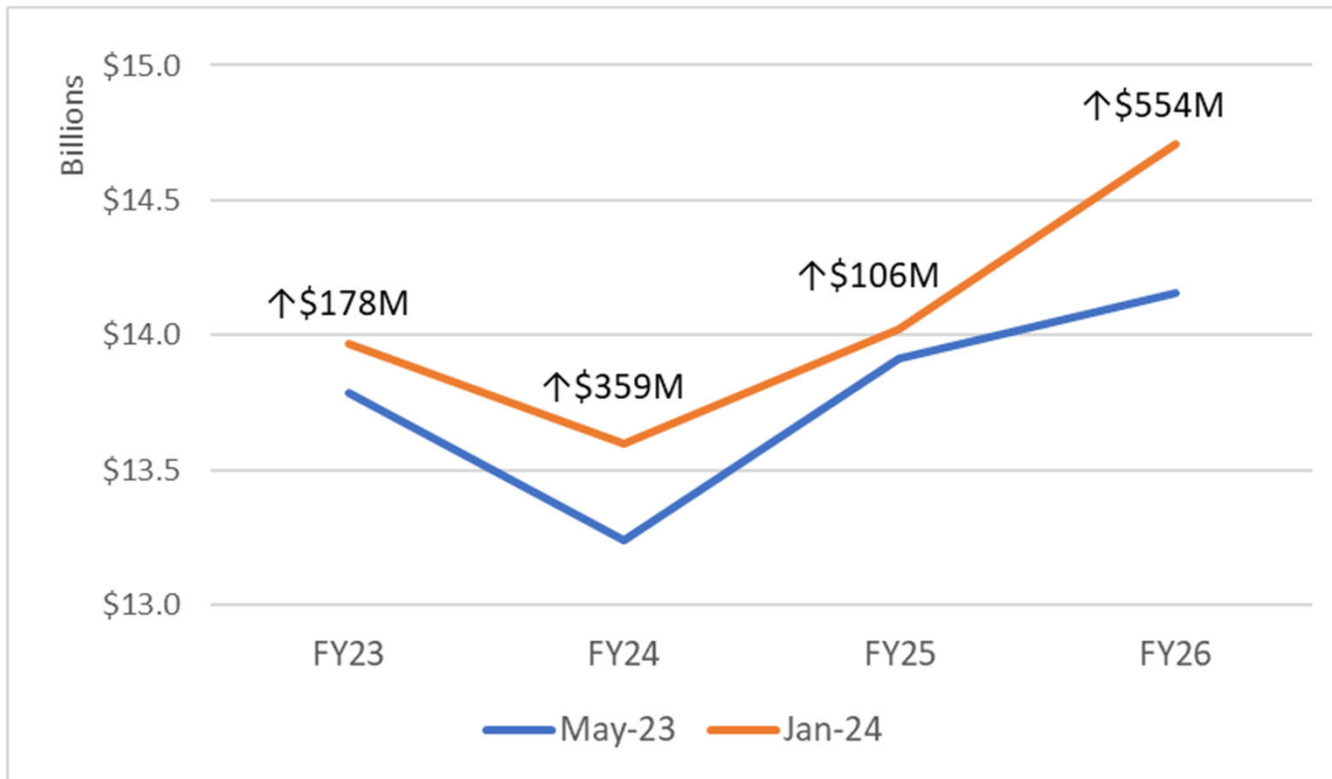
# Craig Thiel, Research Director



- Work Experience
  - 2006 – present: Citizens Research Council
  - 1997 – 2006: House and Senate Fiscal
  - 1995 – 1997: Secretary of State
- Policy Background
  - State budget and taxation
  - K-12 education
  - Transportation
  - Inter-governmental relations
- Education
  - MPA, Wayne State University
  - BA, Kalamazoo College

# The Big Picture: Revenue Situation Facing the Governor

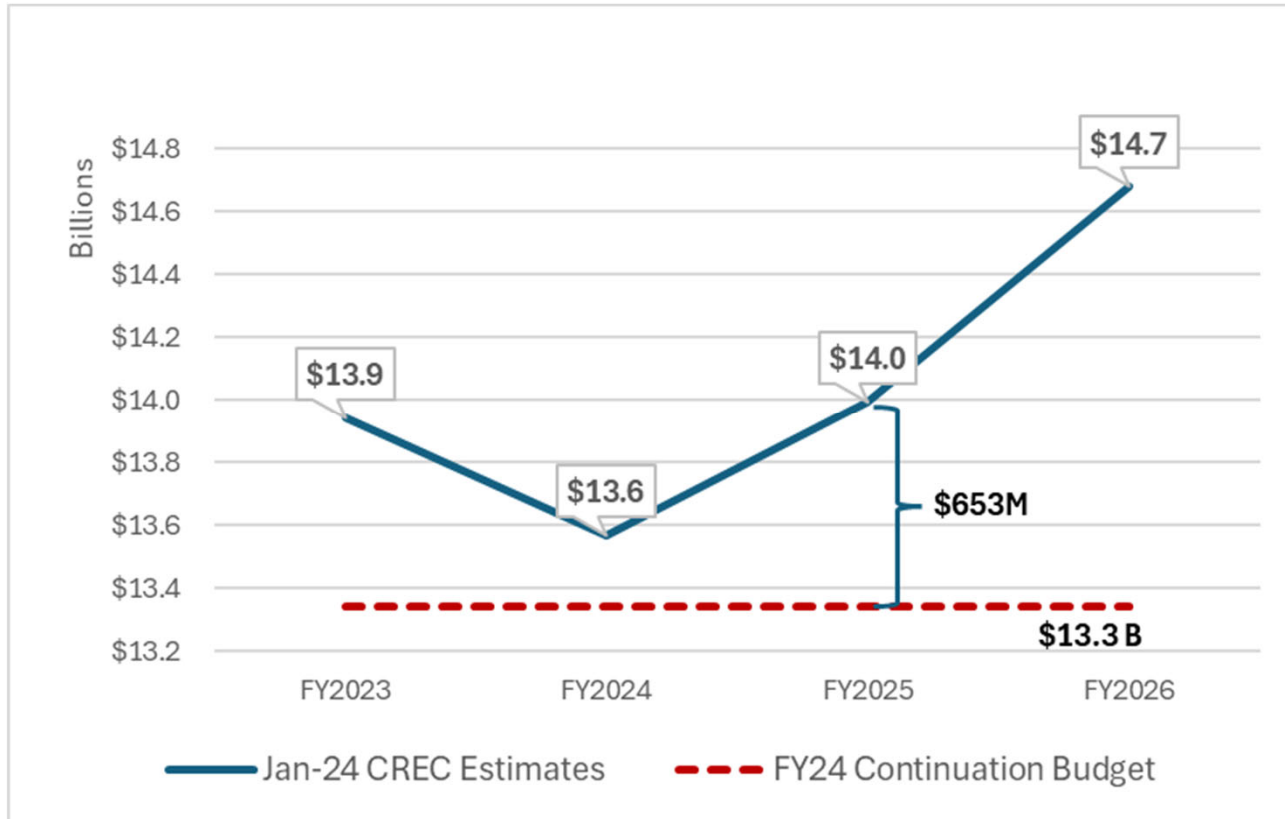
# January Revenue Estimates – General Fund



Source: January 2024 CREC Final Summary.

- GF/GP revenue estimates up somewhat
  - FY23: up 1.3%
  - FY24: up 2.7%
  - FY25: up 0.6%
  - FY26: up 3.9%
- FY26 revenue includes \$550M coming back to GF/GP from Corporate Income Tax

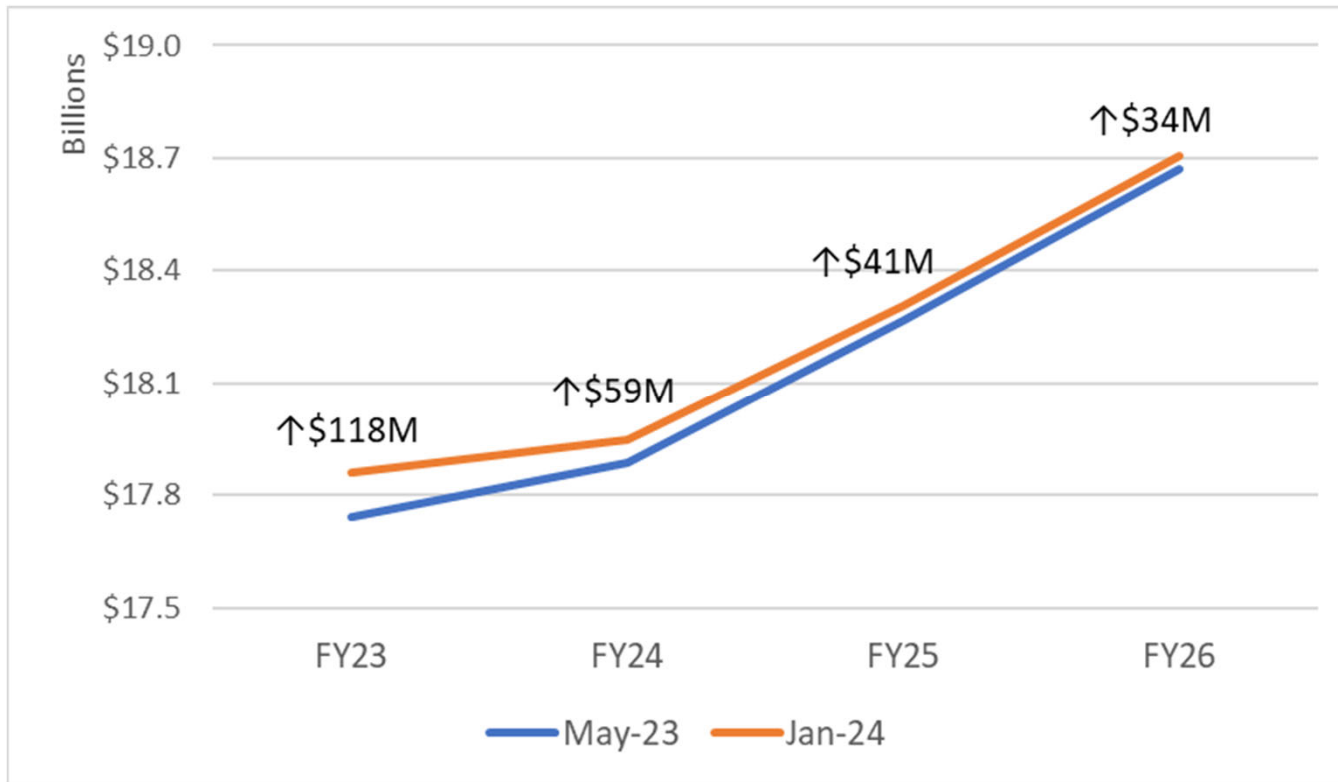
# GF/GP Ongoing Surplus Around \$650M



- GF/GP revenue estimate for FY2025 exceeds FY2024 “baseline” by around \$650M
- Room for about 4.9% growth in ongoing GF/GP budget
- Last year, gap was \$2.5B

Source: Research Council calculations based on Senate Fiscal Agency balance sheet projections and Executive Budget Book..

# January Revenue Estimates – School Aid Fund

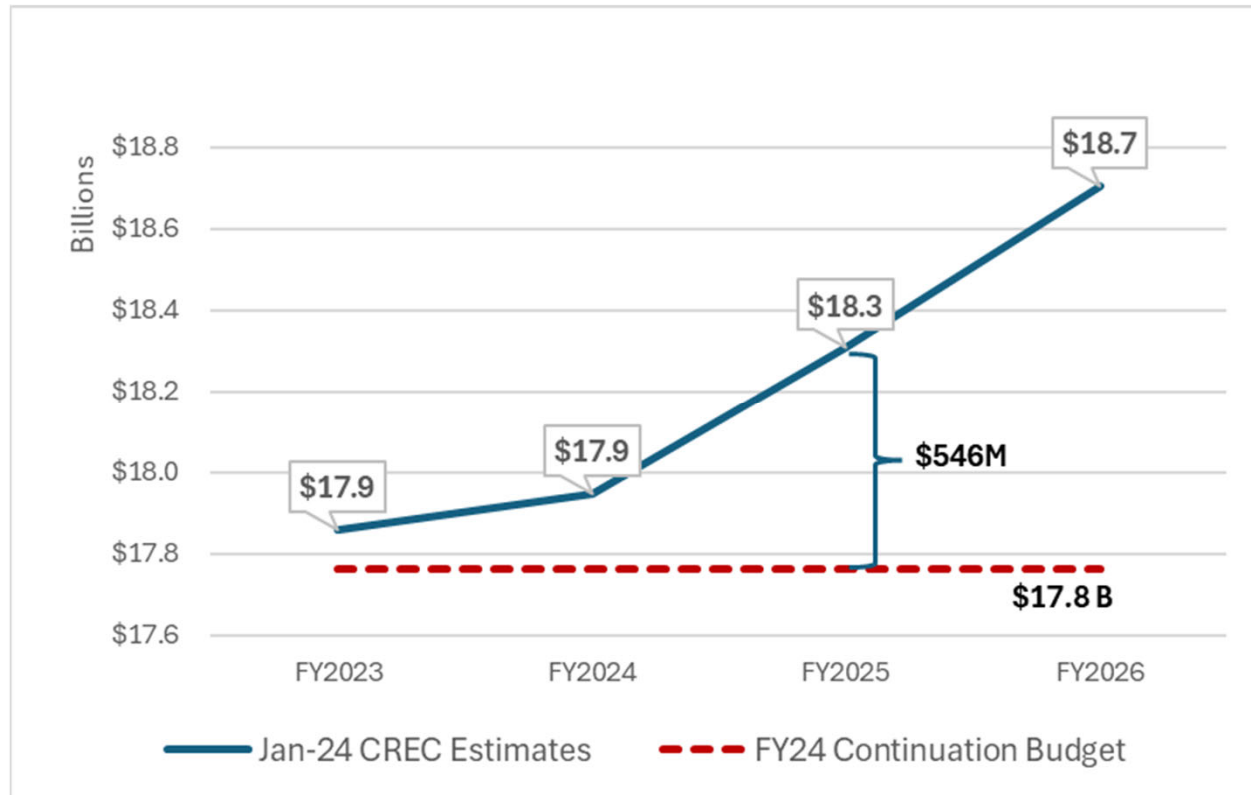


- Very modest upward adjustments in forecasted SAF revenue
- Up less than 1 percent in each year

Source: January 2024 CREC Final Summary.



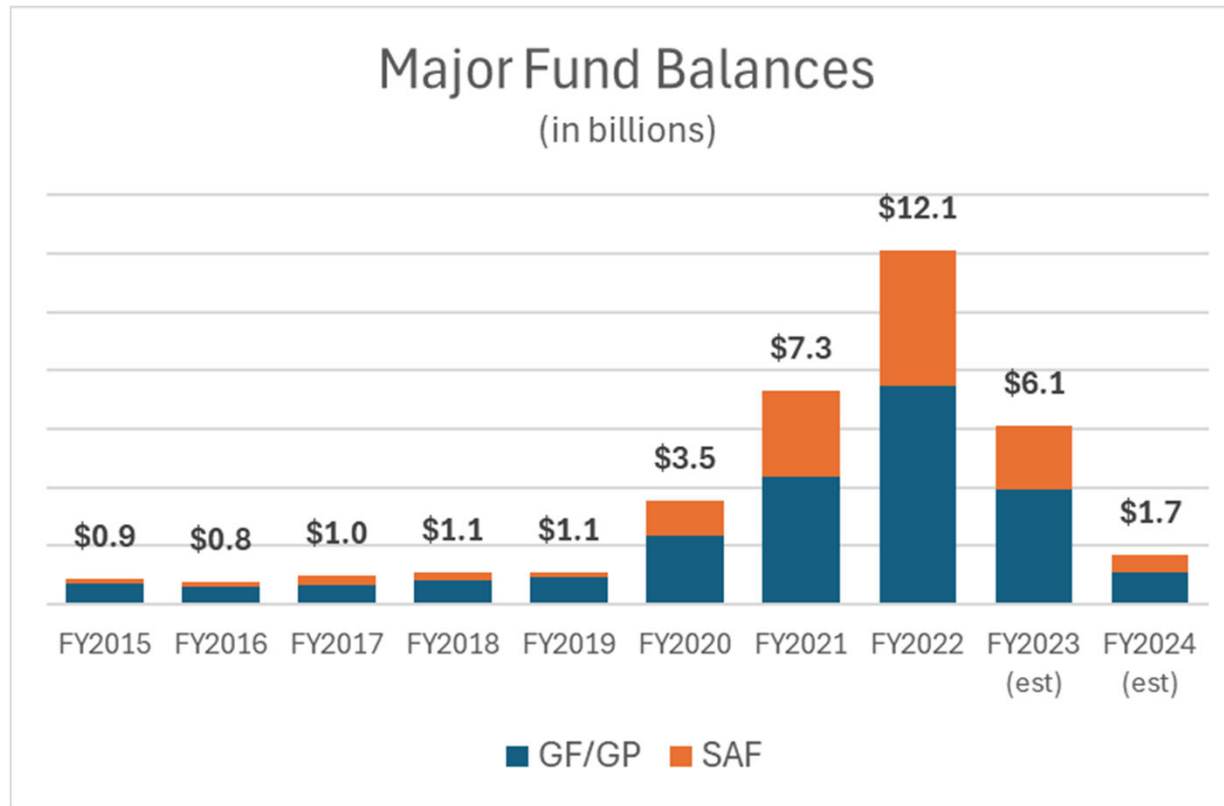
# School Aid Fund: \$550M Ongoing Surplus



- SAF revenue estimate for FY24 exceeds baseline spending around \$550M
- Room for around 3% growth in ongoing SAF budget
- Last year, gap was \$1.3B

Source: Research Council calculations based on Senate Fiscal Agency balance sheet projections and Executive Budget Book..

# State's "Money in the Bank" Has Fallen



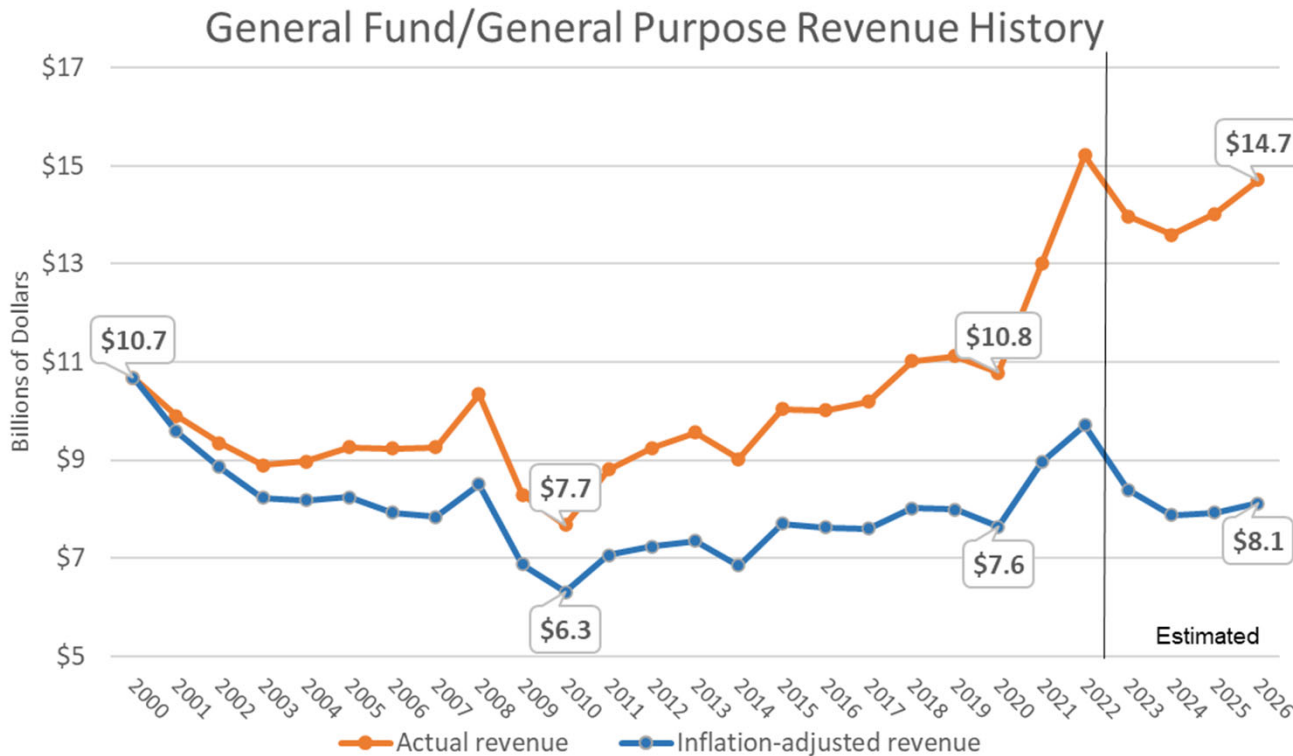
Both GF/GP and SAF projected year-end balances are down from the unprecedented levels realized over the previous four fiscal years.

FY24 Year-End Balance Estimates:

- GF/GP: \$1.1B
- SAF: \$564M

Source: State of Michigan Comprehensive Annual Financial Reports and House Fiscal Agency projections..

# Perspective: Inflation-Adjusted GF/GP Still Down



After climbing out of a two-decade hole, GF/GP revenue is expected to grow by close to \$4B between FY2020 and FY2026

Still, adjusted for inflation, FY2026 revenue estimate is still down by 24% from FY2000

Source: Research Council calculations from Senate Fiscal Agency data. Inflation adjustment uses Detroit CPI-U data.

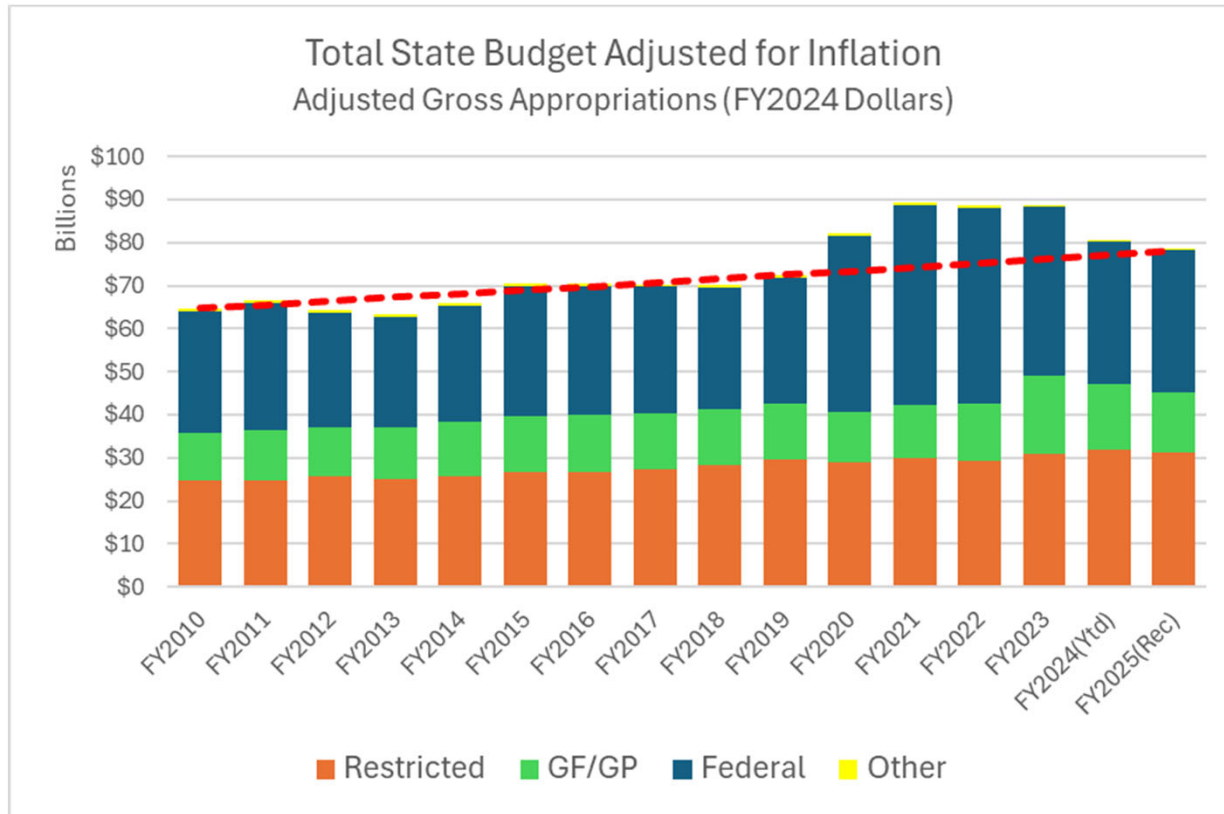
# FY2025 Executive Budget

## Highlights

## Summary of Changes – GF/GP and SAF

	FY2024	FY2025	\$ Chg	% Chg
<b>Total Appropriations</b>	<b>\$80.7B</b>	<b>\$80.7B</b>	<b>\$36M</b>	<b>0.1%</b>
<b>General Fund/General Purpose</b>				
Ongoing Appropriations	\$12.8B	\$13.6B	\$885M	6.9%
One-Time/Supplementals	\$2.4B	\$669M	-\$1.8B	-72.5%
<b>School Aid Fund</b>				
Ongoing Appropriations	\$17.8B	\$18.2B	\$459M	2.6%
One-Time/Supplementals	\$1.6B	\$708M	-\$921M	-56.6%

# Perspective on Recent Budget Growth



Source: Research Council analysis of Senate Fiscal Agency and House Fiscal Agency data

- In actual dollars, FY19 budget \$58B; by FY23 the budget grew to over \$85B
- Growth was largely driven by huge influx of federal revenue as well as one-time spending out of state fund balances
- Proposed FY25 budget returns to pre-COVID trend

# Education Budget Highlights

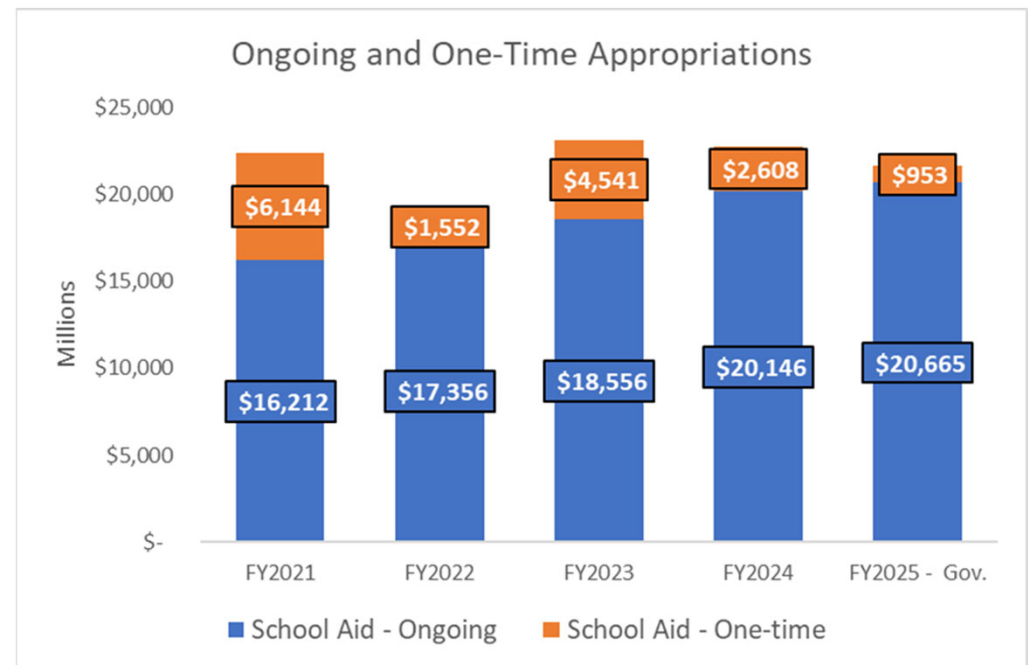
# Background – Context for Executive Budget

- Student academic performance and well-being
  - Serious performance lags across many measures, especially for low-income students
  - Pandemic's profound negative impacts on K-12 learning and achievement
  - On top of academic struggles, student mental health challenges persist
- Return to “normal” revenue growth for School Aid Fund
- School Aid Fund surpluses (one-time and ongoing) largely exhausted
- End of one-time federal ESSER funding in December
  - Statewide: 7% of total General Fund spending (\$1,000 per student) in FY2023
  - Impact of funding cliff varies at individual district level
- FY2025 proposal builds on previous budget priorities
  - Design, develop, and implement a free, universal PreK-14 public education system
    - Expand access to free, publicly-funded PreK programs to all 4-year-olds (remove income eligibility)
    - Expand access to free community college to graduating high school students
  - Provide differentiated funding to meet unique needs of students – “at-risk”, special education, English learners



# Big Picture: K-12 Appropriations

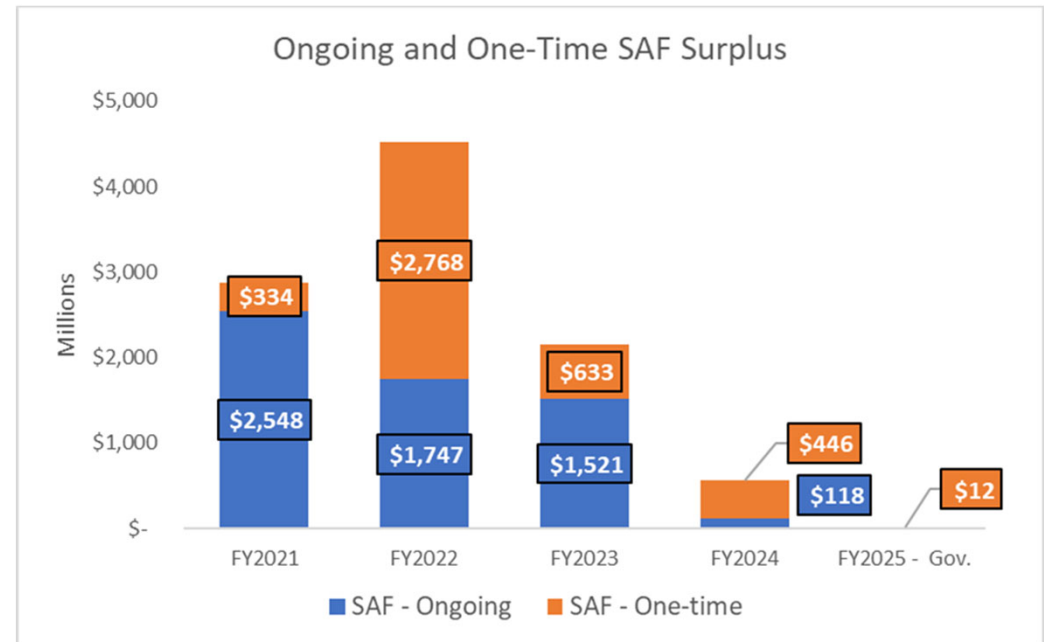
- Return to “normal” budget
  - Ongoing SAF revenue growth slows
  - Ongoing K-12 spending (all funds) up 3% in FY2025 compared to 9% in FY2024 (chart)
  - Total K-12 budget declines 4% in FY2025
- Spend down of SAF surplus
  - One-time appropriations of \$953M in FY2025
    - Down from \$4.5B in FY2023
  - Federal funds appropriated in FY2021, but spent in years since



Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

# Big Picture: SAF Budget Surplus Spend Down

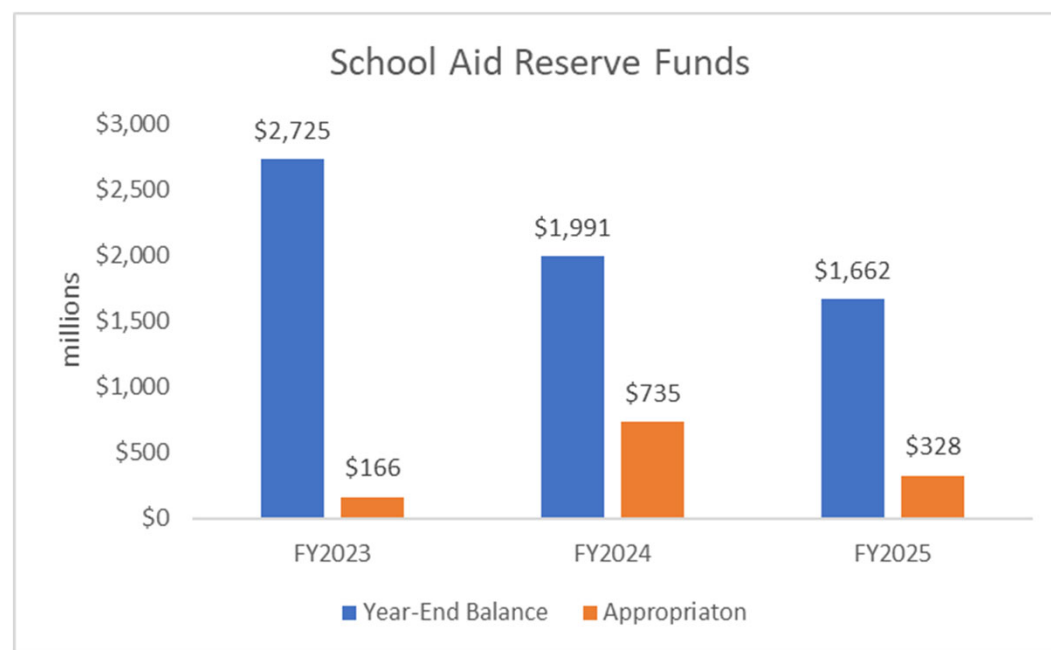
- FY2022 - \$4.5B combined surplus
  - Exhausted in FY2025 (chart)
- Ongoing surplus is function of better-than-expected revenue growth during pandemic
  - These funds later programmed into budget for ongoing items
- One-time resources fueled by various federal stimulus actions and year-end budget surplus



Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

# Some Spending Covered by Reserve Funds

- Deposits of \$2.9B one-time SAF across various “reserve” funds in FY2022/FY2023
  - New “rainy day” fund (\$450M)
  - School infrastructure (\$475M)
  - Declining enrollment (\$314M)
- Reserve funds appropriated over several years
  - \$328M in FY2025
  - \$1.6B remaining FY2025 (chart)



Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

# FY2025 Ongoing SAF Appropriations

## *K-12, community colleges and universities*

- Overall, K-12 appropriations would see an inflationary increase
  - Reminder: year-over-year ongoing SAF revenue increase of \$370M
  - Below surface, budget includes several spending increases that hinge on change to pension funding law
    - Redirects \$632M current dedicated funding for retiree health liabilities to other budget priorities
- Higher education
  - 2.5% increase in operational funding for community colleges; 100% SAF
  - Current-year SAF amount for universities, plus \$94M GF to SAF shift

	School Aid Fund (millions)	
	K-12	Univ. and CC
<b>FY24 Ongoing Approps.</b>	<b>\$ 16,665</b>	<b>\$ 948</b>
Increases - Ongoing Funding	\$ 993	\$ 108
Decreases - Ongoing Funding	\$ (659)	\$ (44)
Baseline Adjustments	\$ 102	\$ (2)
<b>FY25 Exec. Budget</b>	<b>\$ 17,101</b>	<b>\$ 1,011</b>
<i>\$ Change</i>	\$ 437	\$ 63
<i>% Change</i>	2.6%	6.6%

Note: Table excludes appropriations identified as “one-time” for FY2025  
 Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

# School Employee Retirement System Proposal

- Two Components of Michigan Public School Employees Retirement System (MPERS)
  - Pension – \$35B unfunded liabilities (64% funded) as of 9/30/22
    - Scheduled to be fully funded by 2038
  - Retiree Health - \$89M unfunded liabilities (99% funded) as of 9/30/22
    - Projection: 100% funded by FY2025, therefore no amortization payment required
- Current MPERS “funding floor” provision added in PA 181 of 2018
  - Annual payments for unfunded liabilities (pension and retiree health) no less than prior year until ALL liabilities “fully paid”
    - As a result, actual contribution amounts for retiree health well-above actuarially-determined amounts since FY2020; pay-off unfunded liabilities much sooner
  - Proposal seeks state law change to reduce contributions for retiree health component above amount needed for 100% funding
    - This effectively “frees up” \$670M in FY2025 budget

# MPERS Proposal - Budget Impacts

- Governor requesting statutory change to apply funding floor provision to **each separate component** of MPERS unfunded liability (pension and retiree health)
  - Reduces state’s portion of the unfunded liability payment by \$670M in FY2025 (table)
  - Redirects these SAF “savings” to other areas of the budget
- Required employer contributions for unfunded liabilities: **no statutory change requested**
  - State law caps employer contributions at 20.96% of payroll (pension and retiree health combined)
  - \$94M appropriation to reduce employer contribution to 20% of payroll
- Required employee 3% contribution for retiree health: **no change**

Summary of Change (in millions)								
	Pension UAAL Contribution	OPEB UAAL Contribution	Total UAAL Contribution	Employer Payroll	Capped Employer Share	State Share	Sec. 147c (K-12 and Libraries)	Sec. 201(5) (Community Colleges)
FY25, <u>without</u> statutory change	\$3,273.2	\$679.8	\$3,953.0	\$10,410.9	\$2,182.1	\$1,770.9	\$1,671.1	\$99.8
FY25 Executive Budget	\$3,273.2	\$10.4	\$3,283.6	\$10,410.9	\$2,182.1	\$1,101.5	\$1,039.4	\$62.1
<b>Difference</b>	\$0.0	<b>\$ (669.4)</b>	<b>\$ (669.4)</b>	\$0.0	\$0.0	<b>\$ (669.4)</b>	<b>\$ (631.7)</b>	<b>\$ (37.7)</b>

Source: FY2025 Executive Budget Recommendation

# K-12 Budget Highlights

## *Base funding*

- **Foundation allowance** – per-pupil grant funds general operations
  - \$241 increase (2.5%) to \$9,849 per-pupil
  - For FY2025, cyber schools would receive 80% of base foundation (\$7,879); these 16 schools did not an increase in FY2024 (\$9,150)
- **Declining student enrollment**
  - Estimated 0.4% decline in FY2025 and 0.5% decline in FY2026
  - Experiences vary considerably across 836 local districts/charter schools
    - Fewer students = fewer foundation dollars
  - \$71M for enrollment stability payments (same as FY2024)
    - Additional foundation allowance based on 50% of year-over-year student decline

# K-12 Budget Highlights

## *Student-specific funding elements*

- **Students “at-risk” of academic failure**
  - 2.5% increase to “at-risk” formula allocation – total \$976M (up from \$525M in FY2022)
  - Opportunity Index (poverty concentration) used to allocate funds; districts serving the neediest students receive larger per-student allotments
    - Target per-student funding weight - 35% of foundation allowance (currently prorated)
- **Special education students**
  - Full-funding of special education student foundation allowance PLUS required Headlee percentages
  - *New* - \$124M categorical grant to account for special education costs not currently covered by dedicated revenues (replaces current \$74M ISD millage equalization)



# K-12 Budget Highlights

## *Student-specific funding elements*

- **English language learners (ELL)/isolated districts**
  - Increases ELL student funding weights by 7.5% (up to \$1,097 per student)
  - Increases funding for isolated districts by 7.5%
- **High poverty students**
  - *New* - \$90M competitive grant program to address academic, social-emotional, physical needs of children receiving food stamps/cash assistance
  - Estimated 375,000 children qualify for food stamps statewide
  - These students currently qualify for per-pupil “at-risk” payments, but new funding will not be distributed on a per-pupil basis

# Universal PreK Proposal – Budget Impacts

- Goal – 75% of Michigan 4-year-olds enrolled in publicly-funded preschool by 2027
  - Currently, 40% are enrolled across various programs (Great Start, Head Start)
  - Michigan will need to enroll additional 40K children in publicly-funded preschool to reach 75% goal
  - Estimated capacity of existing public programs - additional 6,800 children
- FY2025 funding items – expand access AND capacity for Great Start Readiness Program (GSRP)
  - Removes current income criteria for GSRP eligibility, but maintains requirement for programs to prioritize low-income student enrollment
    - \$64M for additional 6,800 GSRP slots within existing providers
    - \$43M to increase full-day per-child allocation from \$9,608 to \$10,342
    - \$35M (one-time) for preschool start-up grants to expand capacity

# K-12 Budget Highlights – One-Time Funding

*80% of FY2025 one-time appropriations previously funded*

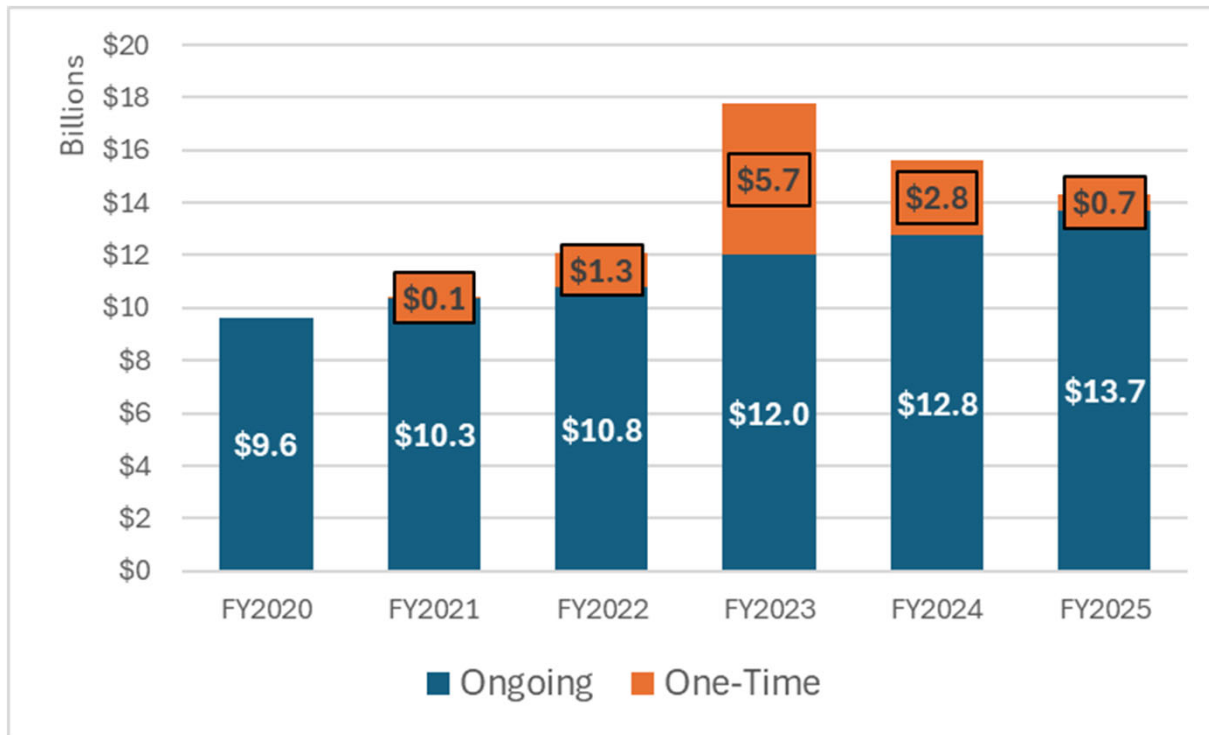
One-Time Funding	Total	Previous
<b>Literacy supports</b> – grants to improve literacy instructional practices	\$155M	No
<b>MI Kids Back on Track</b> – tutoring grants to address unfinished learning	\$150M	Yes
<b>Mental Health</b> – per-pupil payments for student mental health and safety	\$150M	Yes
<b>Grow-Your-Own</b> – grants to encourage existing school support staff to pursue initial teacher certification	\$50M	Yes
<b>GSRP Start-Up Grants</b> – expand capacity of PreK service providers	\$35M	Yes
<b>FAFSA Completion</b> – grants to increase financial aid application completion	\$40M	Yes
<b>TOTAL – one-time appropriations</b>	<b>\$953M</b>	<b>\$762M</b>

# Big Picture Takeaways for K-12 Schools

- FY2025 proposal sets new base K-12 budget going forward now that previous budget surplus has been exhausted
  - 2.5% growth of foundation allowance and other base funding items (e.g., at-risk, special education)
- Key component – pension “funding floor” law change
  - Change frees up \$632M SAF on full-year basis for other K-12 items
  - Used to fund increases for existing programs, fund new programs, and convert some one-time items into ongoing appropriations
  - Without immediate effect, law change would generate one-half of savings

# General Budget Highlights

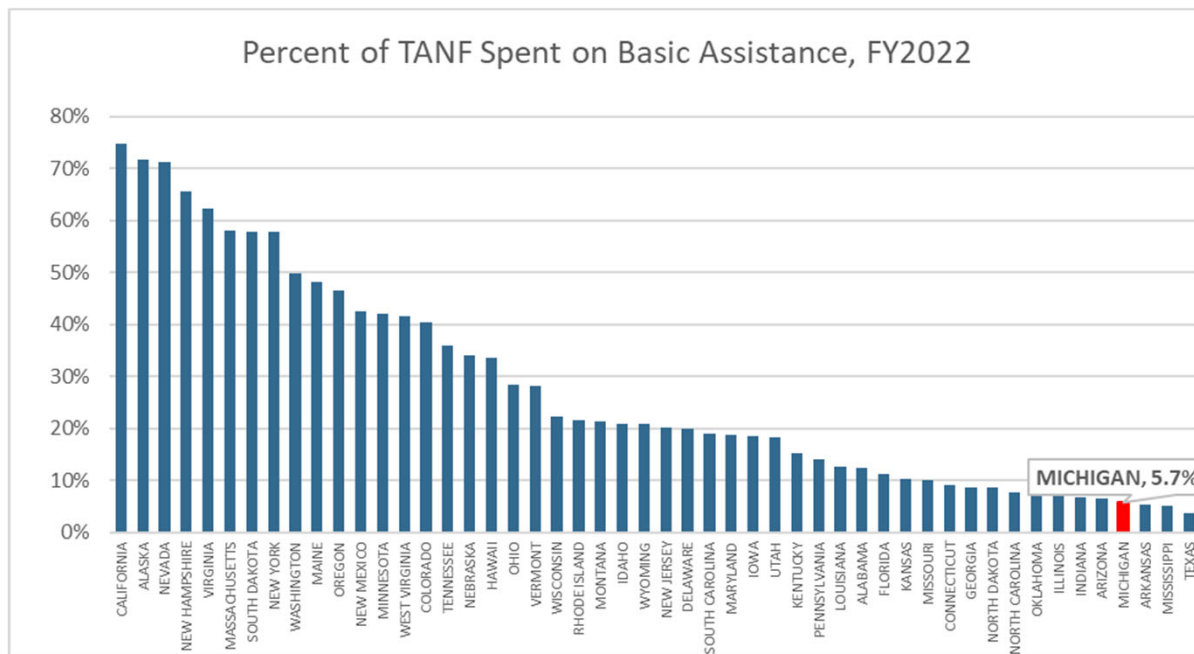
# GF/GP Budget: “One-Time” Funding



- As with the overall budget, Governor’s GF/GP recommendation is marked a shift in appropriations from one-time to ongoing needs
- FY24 GF/GP Budget
  - \$15.6B total
  - \$12.8B ongoing
  - \$2.8B one-time
- FY25 GF/GP Proposed
  - \$14.3B total
  - \$13.7B ongoing
  - \$669M one-time

Source: House Fiscal Agency analyses of enacted budgets and Executive Budget book detail.

# TANF Dollars Redirected to Assistance Programs

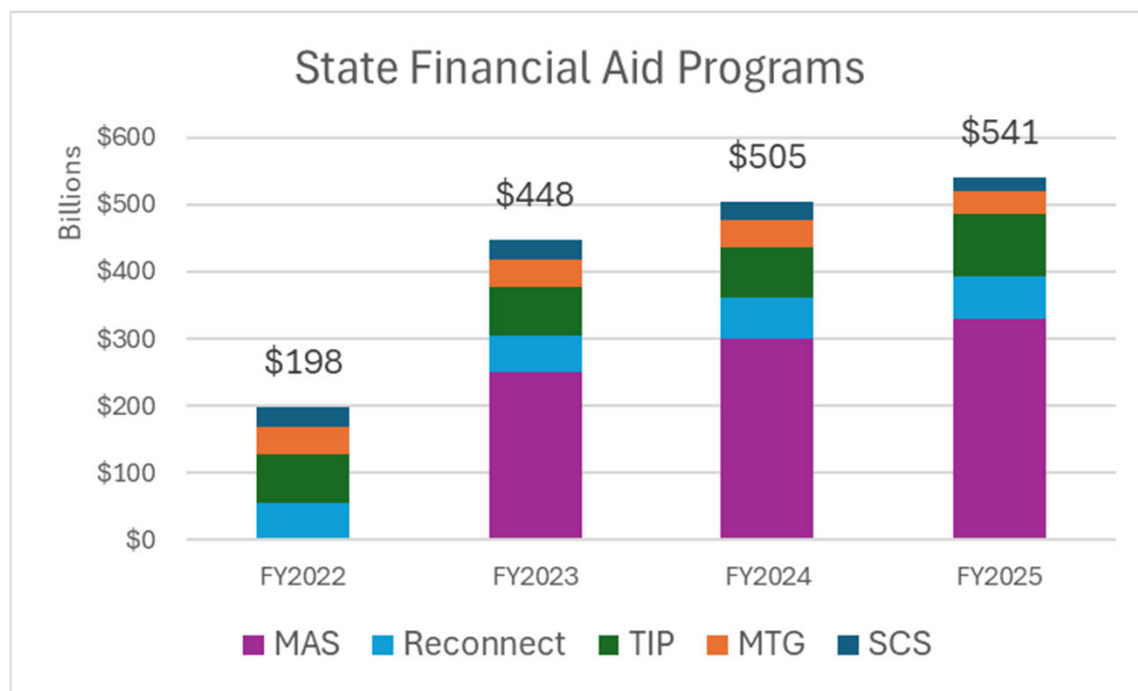


Source: U.S. Health and Human Services TANF expenditure data for FY2022

FY2022 U.S. Average = 39.8%

- Budget proposes to replace \$167.8M in federal Temporary Assistance for Needy Families (TANF) funding for college scholarships and DHHS administration with GF/GP
- TANF is redirected to more traditional social welfare uses:
  - \$64M for child care enhancements
  - \$35M to increase cash assistance payments to low-income families by 35%
  - \$10M to support \$100 monthly increase in assistance for young children under six
  - \$30M to increase emergency crisis assistance
  - \$24M for a Prenatal and Infant Support Program

# Increased Support for Financial Aid Programs



Source: House Fiscal Agency analyses of enacted budgets and Executive Budget book detail.

\$30M increase for Michigan Achievement Scholarships

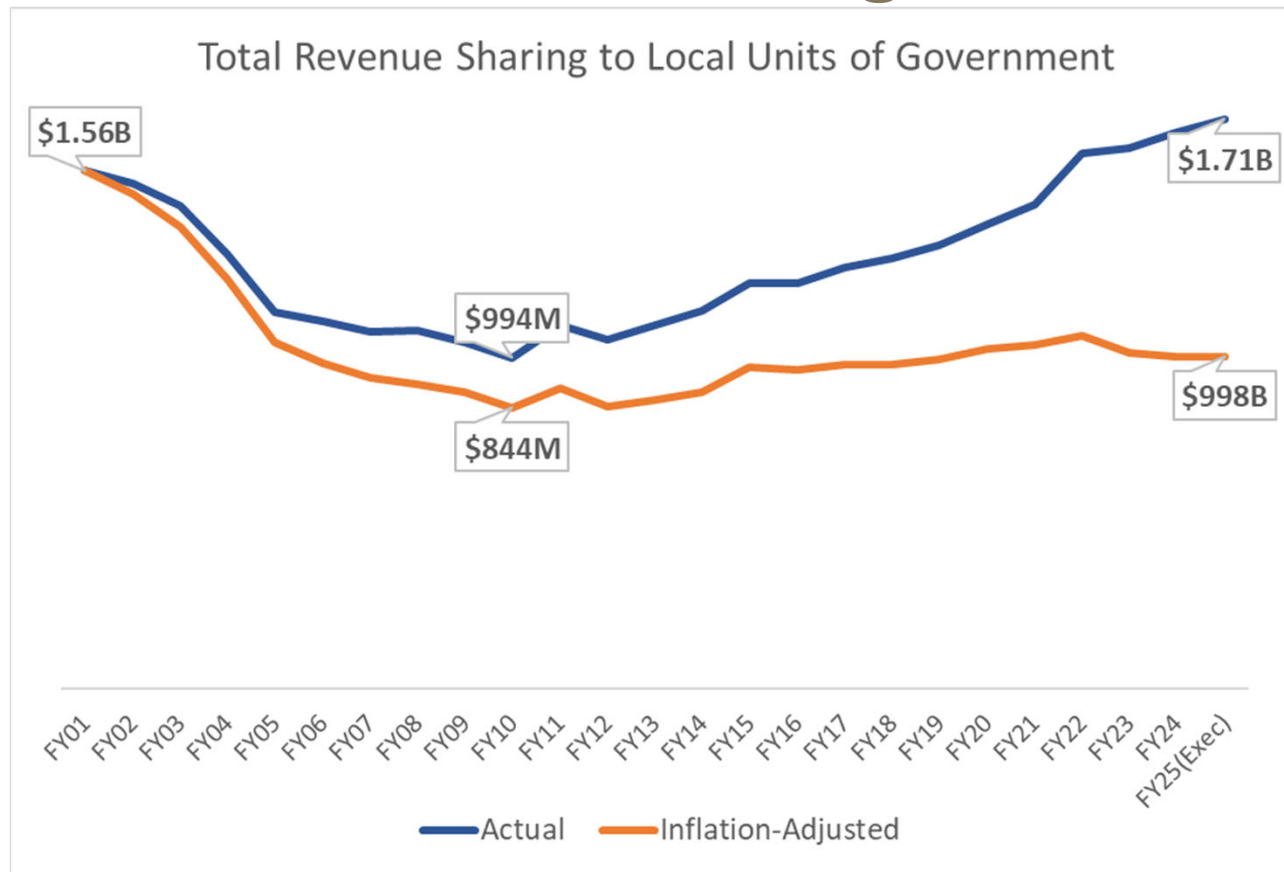
- Community College Guarantee would provide full coverage for tuition for any future MI high school graduate
- Plus \$1,000 for income-eligible students for other costs (e.g. housing)

\$20M increase for Tuition Incentive Program for Medicaid-eligible students

On the other end, proposal begins phase out of State Competitive Scholarships and Michigan Tuition Grants



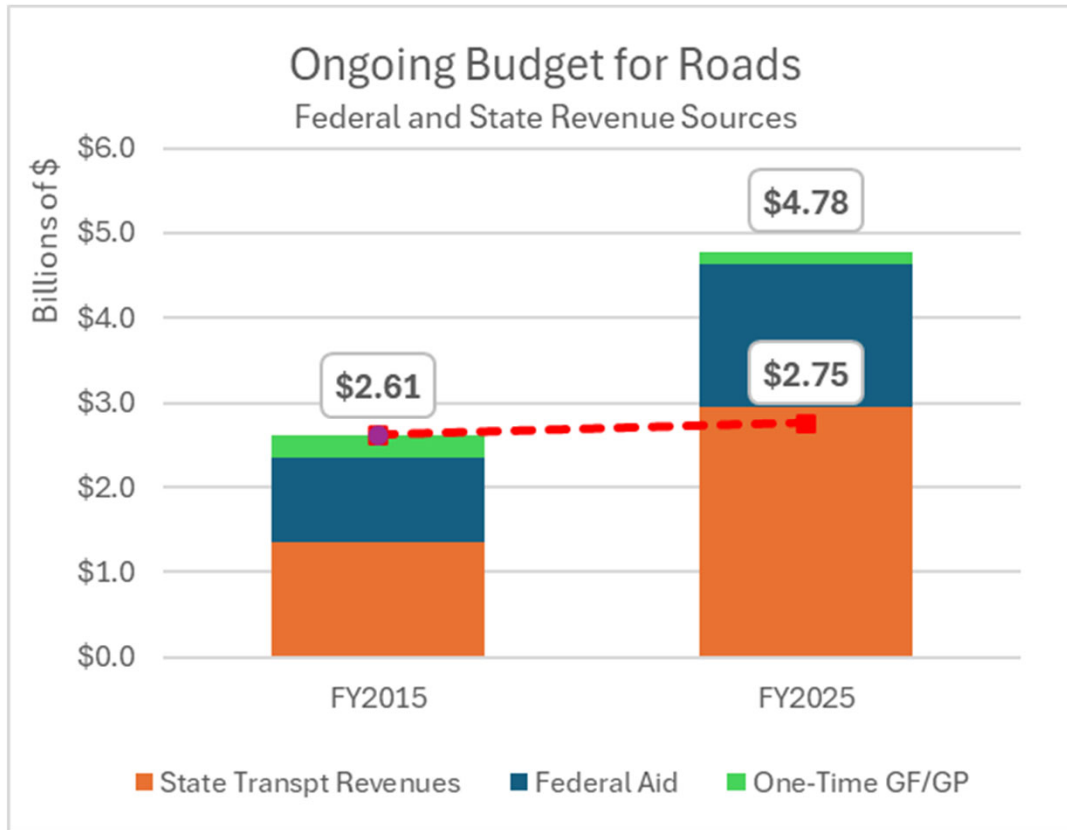
# Local Revenue Sharing



Statutory (discretionary) revenue sharing:

- 5% ongoing increase for all local units of government (\$27.5M)
- One-time increase equivalent to 5% growth (\$27.5)
  - 2% for public safety
  - 3% local fiscal recovery fund incentive

# What About the Roads?



- Governor's Budget includes over \$4.7B for road construction and maintenance projects
  - That includes \$150 million in one-time funding to support federal aid matching requirements and local bridge and culvert projects
- Chart examines changes in appropriations for road projects over the last decade
  - Total funding has increased by 83% due to 2015 road funding reforms and increased federal support
  - However, highway construction inflation has eaten away most of this increase
  - Final \$700M of Governor's \$3.5B bonding plan is due for release

Source: Research Council analysis of FY2015 enacted budget and FY2025 Executive recommendation. Dotted red line adjusts spending for road construction inflation as measured by National Highway Construction Cost index.

# Tax Policy Proposals

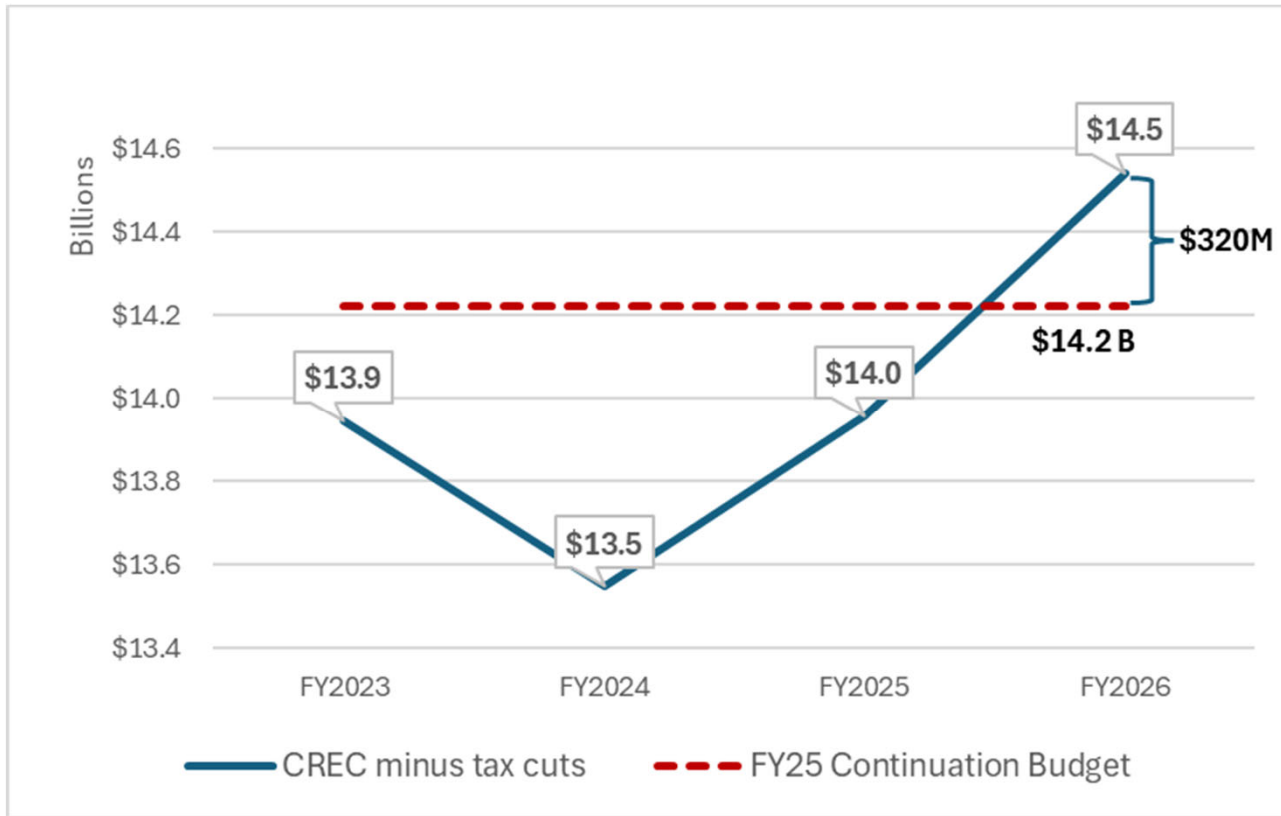
- Research and Development Tax Credit (\$100M): tax credit for companies engaged in qualified research and development efforts
- Caregivers Tax Credit: credit of up to \$5,000 for caregiving expenses on behalf of aging or sick relatives

<b>GF/GP Revenue Foregone</b>	<b>FY2024</b>	<b>FY2025</b>	<b>FY2026</b>
R&D Tax Credit			\$100M
Caregivers Tax Credit	\$22.5M	\$37.5M	\$37.5M
<b>Total Revenue Loss</b>	<b>\$22.5M</b>	<b>\$37.5M</b>	<b>\$137.5M</b>

# Long-Term Budget Outlook

Michigan Budget Looks "Normal" Again

# GF/GP: Room for Only Inflationary Growth

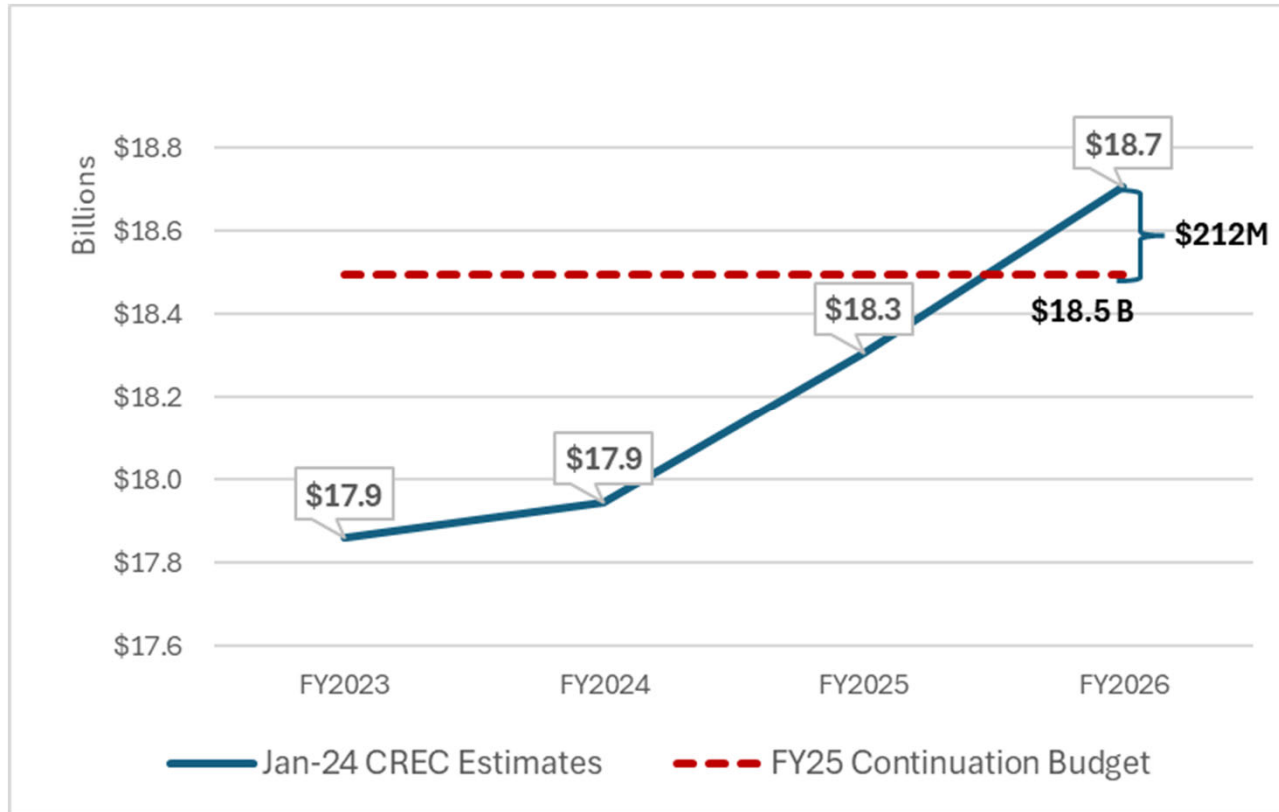


Room for only 2.3 percent GF/GP ongoing budget growth in FY26

GF/GP fund balance would largely disappear by the end of FY25

Source: Research Council calculations Senate Fiscal Agency balance sheet projections and Executive Budget Book..

# SAF: Only Room for 1% Growth in FY26



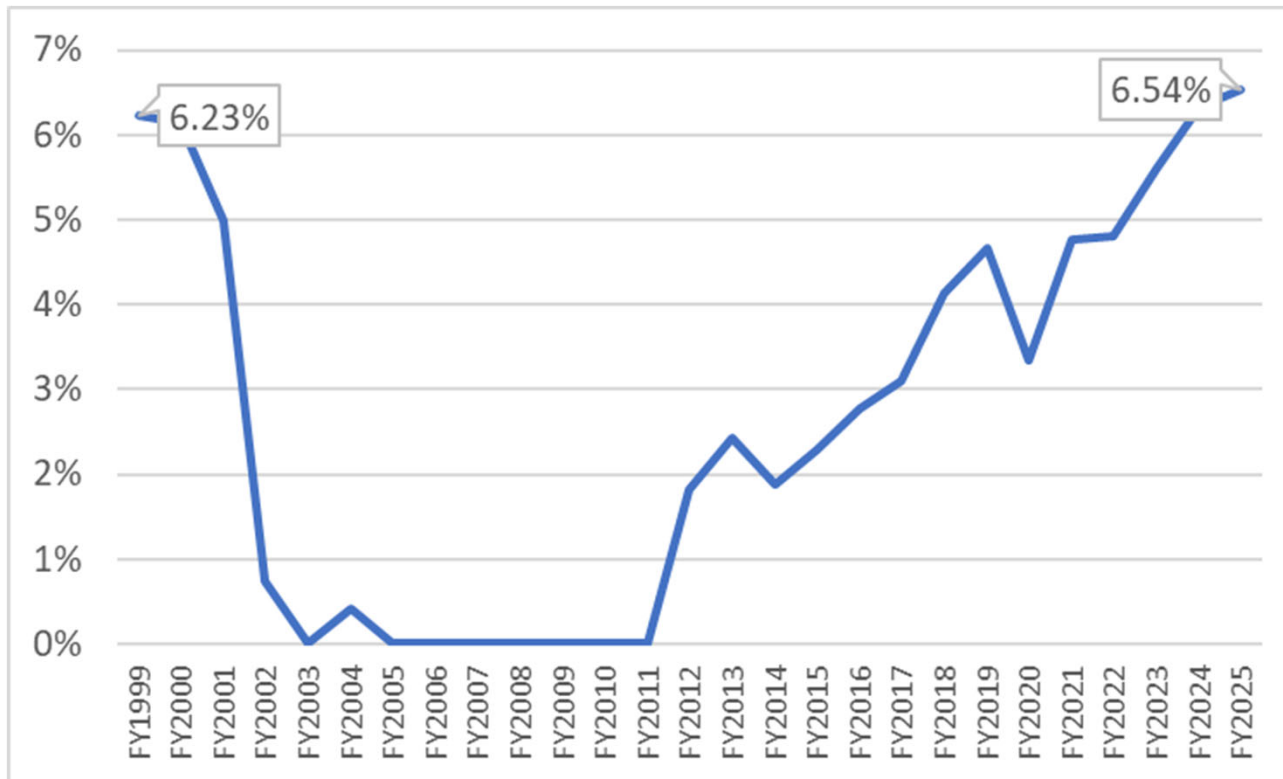
Room for very modest budget growth in FY26 of around \$212M (just over 1 percent)

SAF fund balances would be largely eliminated by end of FY25

Source: Research Council calculations Senate Fiscal Agency balance sheet projections and Executive Budget Book..

# Another \$100M Increase in Rainy Day Reserves

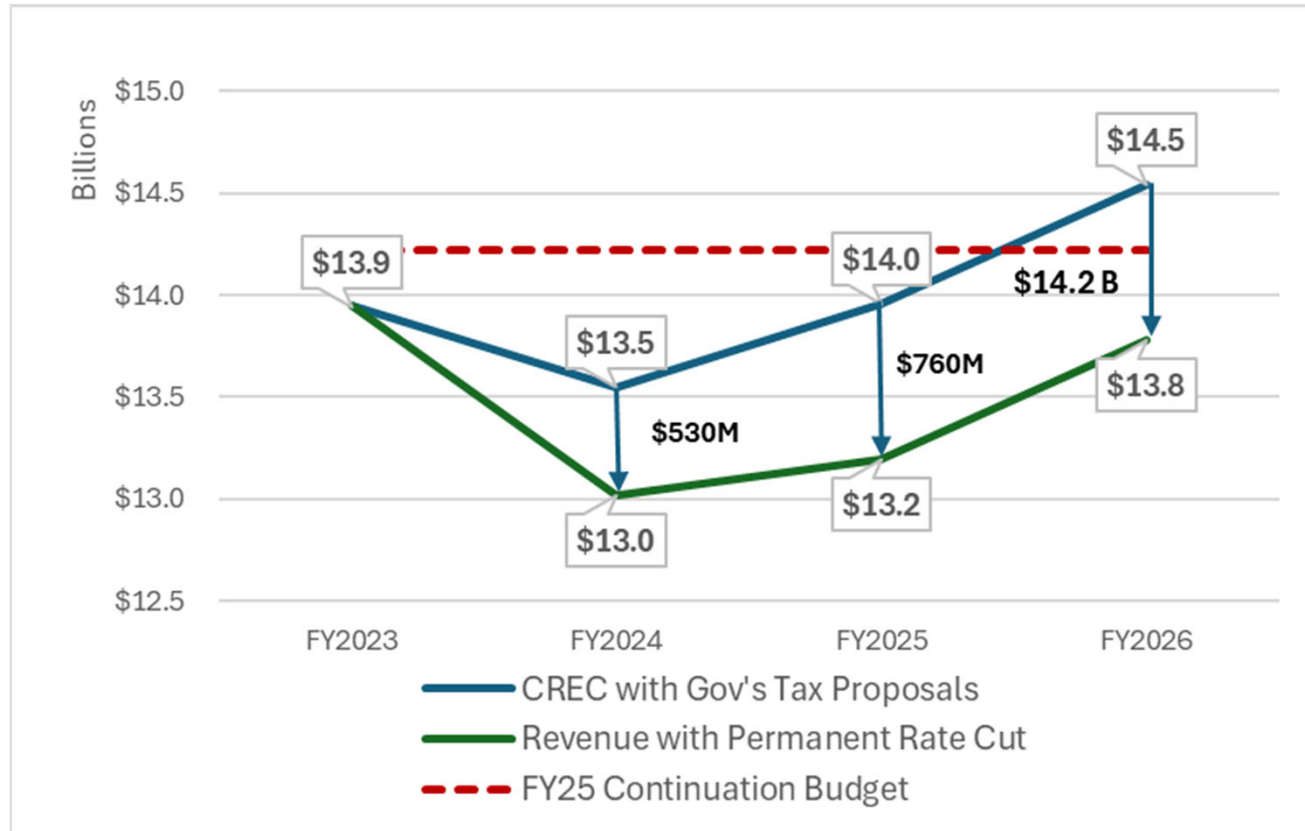
**Budget Stabilization Fund as a Percent of Total GF/GP and SAF Revenue**



Budget Stabilization Fund would grow by \$100 million in FY25, bringing balance to over \$2.2B by the end of the fiscal year

Reserves would equate to over 6.5% of combined GF/GP and SAF revenue, exceeding previous peak in FY99

# What About the Income Tax Rate?



- If courts rule income tax rate cut should be permanent, FY24 GF/GP revenue falls \$530M, and revenue falls by \$760M annually thereafter
- \$1.3B budget hole across both FY24 and FY25 would immediately necessitate major budget revisions



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