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CRC Notes

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How Local Economic Development Programs Affect School Funding

Shortly after the enactment of Proposal A of 1994, CRC published a paper (Council Comments 1029, *How School Finance Reform Affects Municipal Economic Development Incentives*, August 1994) detailing how local governments could continue to use economic development tools such as tax abatements and tax increment financing even after property tax relief. Another side of that issue is the way in which school finance is affected by municipal economic development incentives.

Proposal A of 1994 changed the dynamics of school finance. Prior to 1994, local school districts were relied upon to fund approximately 63 percent of the cost of operating K-12 school districts, with the state contributing about 37 percent. With the advent of Proposal A, the state is responsible for about 80 percent of the funding of local school district operations, and local property taxes are relied upon for about 20 percent. In changing school financing, reliance on property taxes for school funding was reduced and the impact that economic development programs have on school funding was nearly eliminated.

School Funding

Understanding how school districts receive their funding is necessary for understanding the changed impact that these economic development programs have on a district's funding.

District Foundation Allowance. When Proposal A was implemented, each school district's revenue per pupil became its foundation allowance. That value is adjusted each year to reflect growth in the amount of state revenue available for distribution. Except for a few districts with historically high revenues per pupil (those districts that are permitted to levy additional taxes because they received more than $6,500 per pupil in 1993-94 are referred to as hold harmless districts), the current distribution formula increases each district's foundation allowance in a dollar amount equal to the dollar increase in the basic foundation allowance.[1] The money for the foundation allowance comes from two sources: the property tax levy and a distribution from the state school aid fund.

Local Responsibility. Each school district is expected to levy a property tax for school operations of 18 mills or the number of mills levied in 1993, whichever is less, on the taxable value of non-homestead property. The local responsibility is the sum of:

1. The local school tax rate multiplied by the per pupil taxable value of *non-homestead* property in the district (School districts are assumed by the state to levy the full tax rate available to them);
2. Any tax revenue captured due to tax increment financing.

The State Share. The state share of the district foundation allowance is the difference between the district's foundation allowance and that district's local funding responsibility.

When the property tax base of a local school district grows because of new development, the yield from the school tax levy increases and less money is necessary from the School Aid Fund. When the property tax decreases due to either subtractions from the base or exemptions, more money comes to the school district from the School Aid Fund. The district foundation allowance is not affected in either case.

Economic Development Programs

Two tools available to Michigan municipalities to promote economic development are tax abatements and tax increment financing. The effect of each on local school finances is negligible.

Tax Abatements. In general, the impact of abating or exempting property was reduced because Proposal A reduced the overall property tax burden. To the extent that Michigan municipalities continue to use tax abatements, they currently are available through several programs:

- The Plant Rehabilitation and Industrial Development District Act (PA 198 of 1974) allows municipalities to provide incentives for industrial development. When a certificate is issued to a business under this act, the property becomes ex-

[1] The basic foundation allowance is a reference value used for determining changes in district foundation allowances and allocating funding to charter schools. It varies from year to year using a formula provided in the State Aid Act that takes into account the change over time in both pupil memberships and available state revenues.

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empt from general ad valorem taxation and becomes subject to a specific tax, generally equal to 50 percent of the general ad valorem taxes it replaces. (The state treasurer may abate all, 50 percent, or none of the 6-mill State Education Tax).

- The Neighborhood Enterprise Zone Act (PA 147 of 1992) and Obsolete Property Rehabilitation Act (PA 146 of 2000) operate similar to PA 198: certificates are issued exempting the property from general ad valorem taxation and a specific tax is levied equal to 50 percent of the statewide average tax rate.
- Public Act 328 of 1998 allows certain distressed municipalities to exempt from taxation the new personal property of businesses in certain sectors of the economy. No tax is levied in lieu of the exemption, new personal property is simply exempt from taxation.
- The Michigan Renaissance Zone Act (PA 376 of 1996) allows municipalities to create zones within which almost all property is subject to tax abatement. In an effort to revitalize economically distressed areas of the state, renaissance zones define areas within a local unit. All property within those areas, both residential and business, are completely exempted from a number of taxes, including general ad valorem taxation.

Because these tax abatement programs exempt properties from general ad valorem taxation, the value of the properties is removed from the property tax rolls. This value is not included in the per pupil taxable value of property used to calculate the amount of revenues expected to be raised as the school district's responsibility. As a result, the issuance of a tax abatement reduces the amount of revenue a school district could expect from its property tax levy, but the amount of revenue received by the district from the state school aid fund increases in a commensurate amount.

While increased state funding compensates for revenue losses resulting from tax abatements, the state does not make up for lost revenues resulting from tax abatements for purposes of hold harmless millages or for debt millages.

Tax Increment Financing. Municipalities use tax increment financing to finance infrastructure improvements by "capturing" property tax revenue increases above an established base valuation. Municipalities may engage in tax increment financing through four programs: downtown development authorities (PA 197 of 1975), tax increment finance authorities (PA 450 of 1980), local development finance authorities (PA 281 of 1986), and brownfield redevelopment finance authorities (PA 381 of 1996).

The example below illustrates how tax increment financing works. Taxes levied against the captured assessed value by all taxing jurisdictions are "captured" by the municipality for the infrastructure projects of the tax increment financing district.

Since the implementation of Proposal A, school taxes can be captured by tax increment financing districts for limited purposes. School taxes are subject to capture only to the extent that they are needed to repay obligations entered into prior to 1995. Newly created tax increment finance districts cannot capture taxes levied for school purposes.

Tax Increment Financing

Initial Assessed Value of tax increment area	$10,000,000	
Assessed value of new private development	1,500,000	
Inflationary increase in value of existing property	+ 500,000	
Total Assessed Value		$12,000,000
LESS		
Initial Assessed Value		- 10,000,000
EQUALS		
Captured Assessed Value		$2,000,000

Source: Michigan Department of Education, Michigan School Accounting Manual, http://www.state.mi.us/mde/off/stateaid/sc-ii.pdf.