The Basics of School Funding

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School Finance

How are Local School Districts Financed?

Three Primary Sources

- Local Taxation
- State Funding
- Federal Funding

Part I

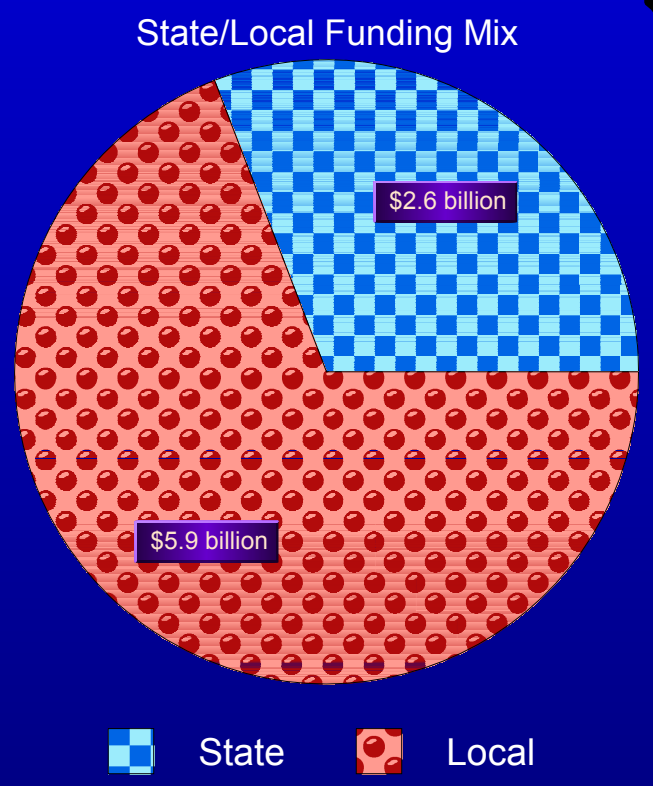
How the State Raises Revenues for Schools

The first part of the presentation will discuss pre-Proposal A, Proposal A, and post-Proposal A taxation rates and how the State finances the K-12 system in general.

BEFORE Proposal A

Local Taxation Plays a Large Role

Prior to Proposal A, schools were financed primarily through local property taxes. In fact, in 1993-94, home and business owners were paying on average 33 operational mills assessed on the State Equalized Value (50% of market value) of their properties. At that time, local taxation accounted for roughly 69% of the State/local split of school finance, with State funding making up the other 31%.



The School Aid Fund at that time consisted of:
Sales Tax: 60% of proceeds at 4% rate;
Cigarette Tax: 2 cents of 25 cents/pack tax;
Lottery: Net Revenue;
Industrial and Commerical Facilities Tax: Paid to the SAF for properties of "in-formula" districts;
Commerical Forest Tax: same as above;
Liquor Excise Tax: Revenue from 4% excise tax.

What Spurred Proposal A?
Public Act 145 of 1993

- In July of 1993, the Legislature approved, and the Governor signed into law, P.A. 145 of 1993.
- This law exempted all real and personal property taxes for school operating purposes beginning in 1994.
- This law eliminated approximately 64% or $6.4 billion of $10.0 billion of total K-12 school funding beginning in FY 1994-95.
- The Legislature had approximately five months to create a new funding structure.

PROPOSAL A

How Did the Method of Financing Schools Change?

1. State School Aid Fund

- Sales Tax Increased from 4% to 6%, with 100% of the Revenue from the Additional 2% Dedicated to the School Aid Fund (SAF);
- Use Tax - All Revenue from the 2% Increase --SAF;
- State Education Tax Assessed on the *Taxable Value* of all Property at 6 mills;
- New Real Estate Transfer Tax - 0.75% applied to the selling price of the property;
- Cigarette Tax - increased from 25 to 75 cents per pack, with 63.4% of the increase dedicated to the School Aid Fund. (August 1, 2002 saw a 50 cent increase, 20 cents of which was dedicated to the SAF. This tax increased again on July 1, 2004, to $2.00/pack; none of the 75 cent increase was dedicated to the School Aid Fund.)

School Aid Fund Earmarked Taxes and Lottery
January 2017
Consensus Revenue Estimating Conference

Fund Source (in Millions)	FY 2017-18 Estimate
Sales Tax	$5,583.0
Use Tax	$560.9
Tobacco Taxes	$348.4
State Education Tax (6 mills)	$1,990.6
Real Estate Transfer Tax	$309.8
Industrial Facilities Tax	$36.0
Income Tax	$2,864.3
Lottery	$892.0
Casino Tax	$115.0
Other	$83.1
Total (in Millions)	$12,783.1

PROPOSAL A

How Did the Method of Financing Schools Change?
2. Local Taxation

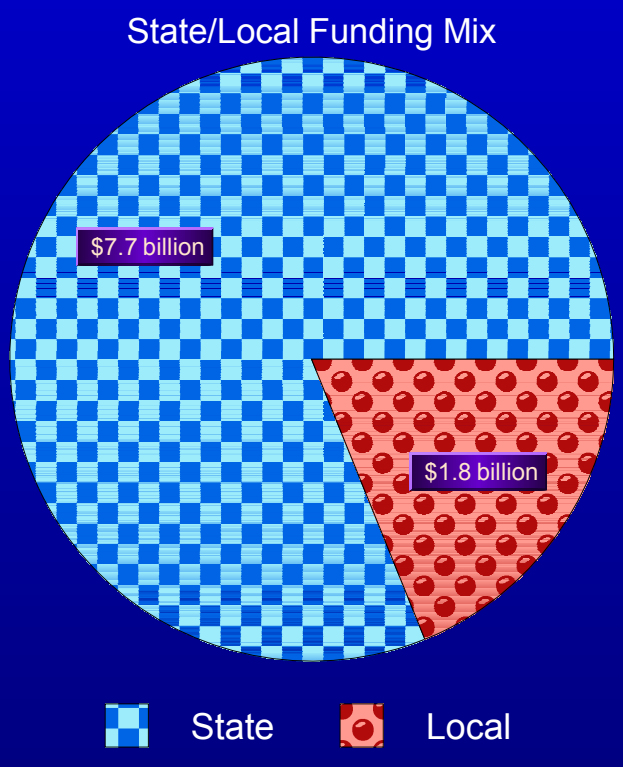
- In general, local taxation for operations (not including debt/capital or sinking fund) is capped at 18 mills levied on the *taxable value* of non-homestead property, with no operational mills levied on homesteads (there is an exception for "hold-harmless" districts);
  - Homesteads: Taxpayer's primary residence, including noncommercial agrilcultural property.
  - Non-homesteads: All other property such as business, rental property, vacation homes, and commercial agriculture.

Also, *taxable value* increases are capped at the lesser of the rate of inflation or 5%. SEV continues to grow uncapped, and taxable value=SEV when a property transfers ownership.

AFTER Proposal A

How Did Local Taxation Change?

After the passage of Proposal A in March 1994 by the voters of Michigan (69% Yes, 31% No), average operational mills decreased to 6 mills levied on homeowners by the State for the State Education Tax (SET), and 24 mills for non-homesteads (6 mills for the SET, 18 mills levied by schools). This reduction in property taxes, and increase in State revenues for schools, changed the State/local funding mix to approximate an 80%/20% split.



AFTER Proposal A

Local Taxation Can and Does Still Occur

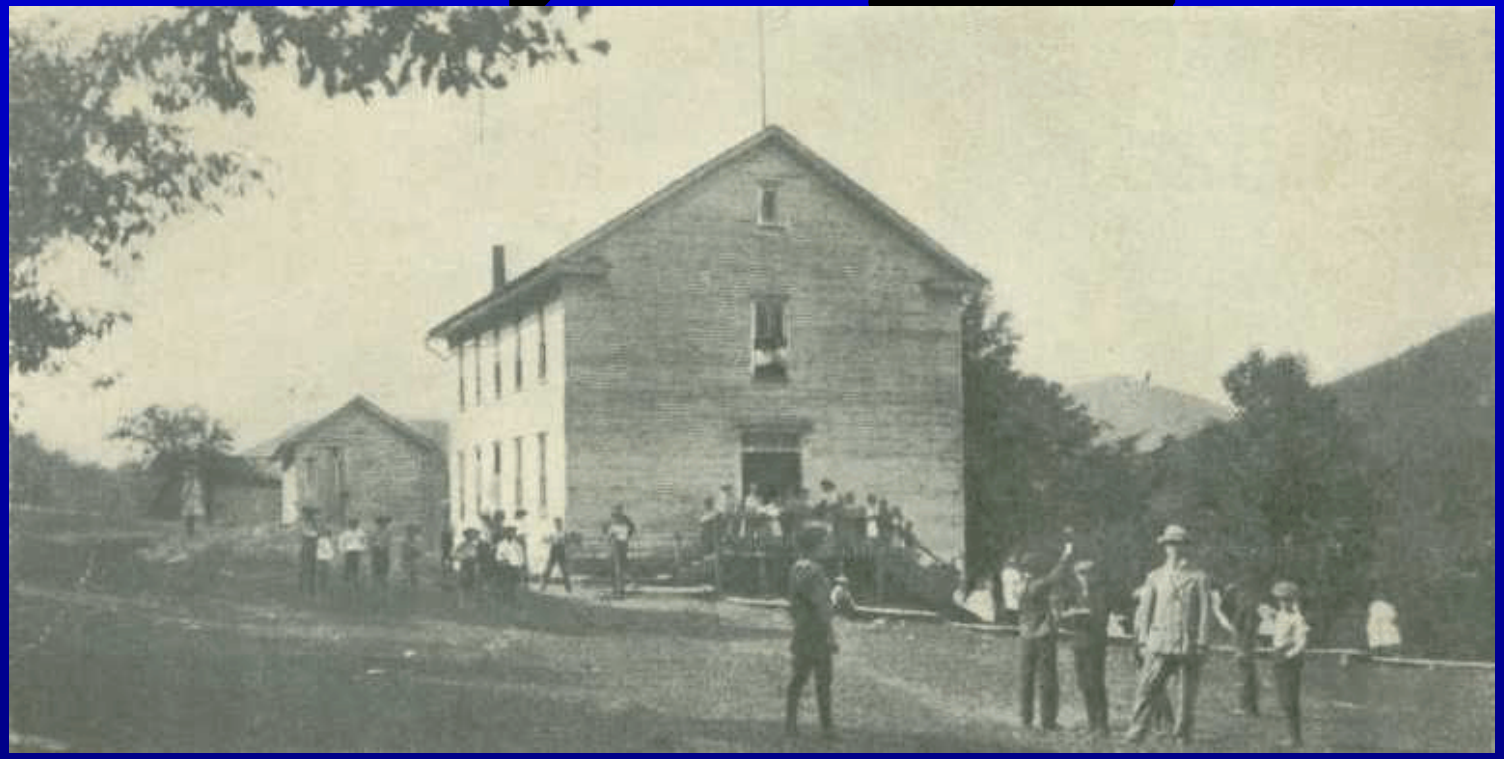
School district voters still must approve the mills assessed on non-homesteads, and are required to renew these mills over time. School districts also may ask voters for approval to levy mills for *debt* (i.e., capital outlay to build or renovate facilities), *sinking funds* (i.e., purchase of land for future building projects), and to enhance funding for *operations* on an Intermediate School District-wide basis only (up to 3 "enhancement" mills).

(Only four ISDs are levying an enhancement millage for operations: Monroe at 0.9866 mill, Kalamazoo at 1.5 mills, Midland at 1.5 mills, and Muskegon at 1.0 mills.)

Part II

Funding at the School District Level

Now that we've covered how State funding of schools has changed with Proposal A, we will turn to a discussion of funding at the district level.



Financing for Schools

Before Proposal A: Guaranteed Mill Amount

Prior to Proposal A, schools received local property tax revenue as determined by voters, plus State aid. If districts were “in-formula”, they received State funds so that they were guaranteed a dollar amount for each mill levied. There were 381 “in-formula” and 177 “out-of-formula” districts. Districts also received categorical aid for specific expenditures, such as School Readiness and Special Education.

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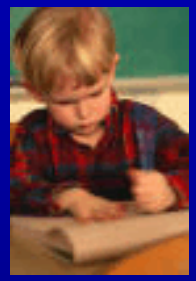
Financing for Schools

After Proposal A: the Foundation Allowance Concept

After Proposal A, school funding was tied to each pupil counted in a district's membership. Districts receive a foundation allowance, which is a per-pupil funding amount initially determined in 1994-95 based on what the district was receiving on a per-pupil basis in 1993-94. A minimum level of funding was established ($4,200), a target level (the "basic") was determined ($5,000), and a "cutoff" point for State Aid was set ($6,500), with dollars above that point raised from local mills.



State/Local Funding of Foundation Allowance

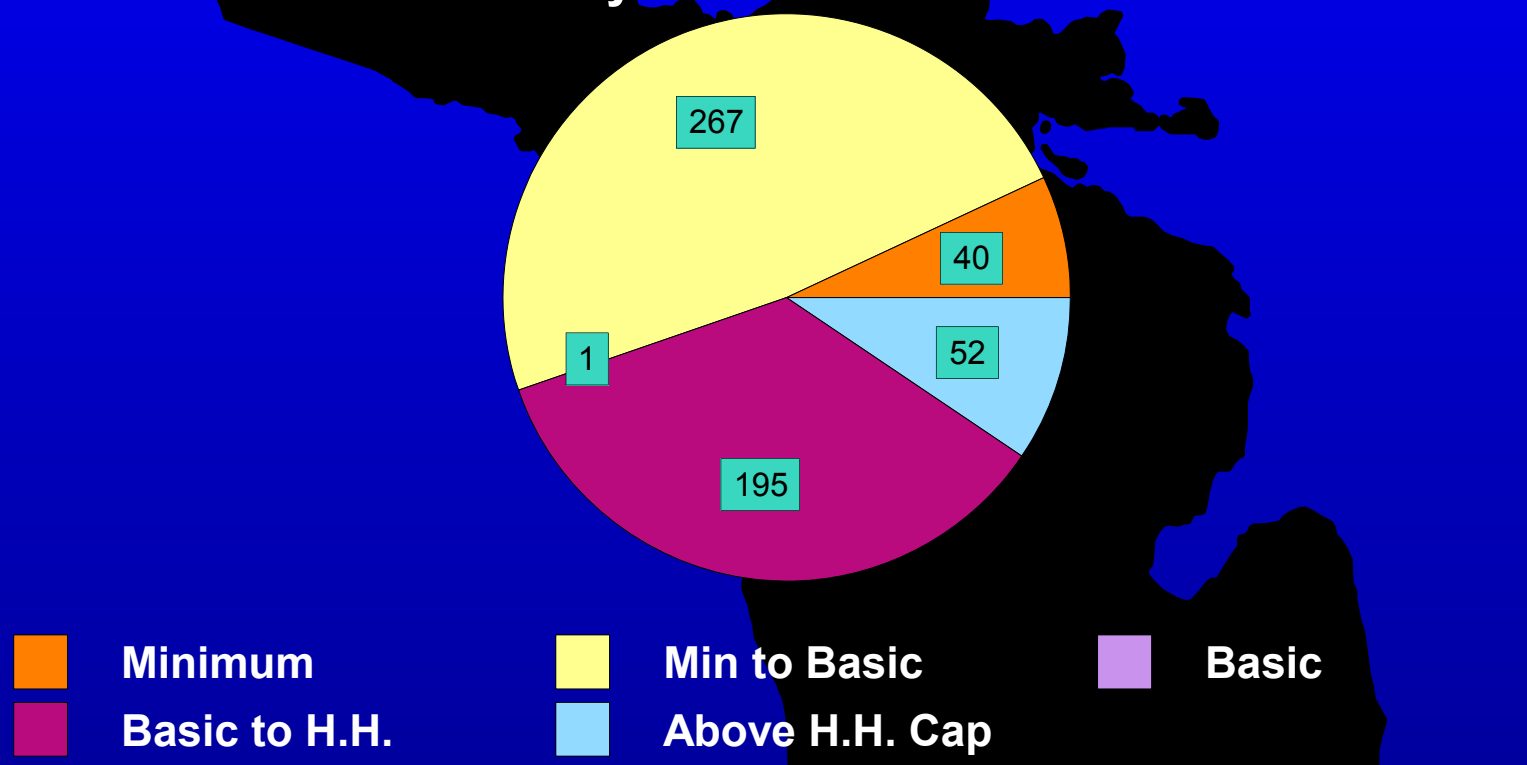
- Each district must levy 18 mills on non-homesteads.
- Local revenue from 18 mills is calculated at the State level on a per-pupil basis.
- State deducts the per-pupil local revenue from the lesser of the foundation allowance or hold-harmless "guaranteed" per-pupil amount.
- Districts above the hold-harmless cap are allowed by law to levy additional mills (with voter approval) to achieve their prescribed foundation allowance.

	Munising Public Schools
1994-95 Foundation	$4,200
1994 Non-homestead T.V.	$45,545,273
1994-95 Pupils	1,107.34
18 Mills (Per-Pupil Basis)	$740
State Aid (Per-Pupil Basis)	$3,460
Hold-Harmless Millage Rev. If Nec.	$0
	Central Lake Schools
1994-95 Foundation	$5,961
1994 Non-homestead T.V.	$62,930,152
1994-95 Pupils	504.4
18 Mills (Per-Pupil Basis)	$3,715
State Aid (Per-Pupil Basis)	$2,246
Hold-Harmless Millage Rev. If Nec.	$0
	New Buffalo Schools
1994-95 Foundation	$8,527
1994 Non-homestead T.V.	$203,811,384
1994-95 Pupils	651.24
18 Mills (Per-Pupil Basis)	$5,633
State Aid (Per-Pupil Basis)	$867
Hold-Harmless Millage Rev. If Nec.	$2,527
Hold-Harmless Mills Levied	12

1994-95 Foundation Allowances

Five Groupings of Districts' Per-Pupil Funding

Numbers of Districts by 1994-95 Foundation Allowance Grouping



Minimum	$4,200	40
Min to Basic	$4,200-$5,000	267
Basic	$5,000	1
Basic to H.H.	$5,000-$6,500	195
Above H.H. Cap	Above $6,500	52

Dollar Increases in the Basic Foundation Grant

- The amount of available State funding determines the increase in the BASIC foundation allowance.
- Every district at or above the BASIC foundation gets the same dollar increase as is given to the Basic.
- Between '95 and '00, districts at the minimum foundation got TWICE the dollar increase of the Basic Foundation grant, in order to partially close the funding gap. Between '01 and '07, all districts received the same dollar increase per pupil. The "2x" formula was reinstated in FY 2007-08 and the basic was increased to the hold harmless/"State max" level of funding.
- **In FY 2009-10, districts' State aid payments were reduced $154 per pupil, and in FY 2010-11, they were reduced $170 per pupil (when compared to FY '09 funding levels). However, these reductions did NOT statutorily roll back foundation allowances, until FY 2011-12 with an additional $300 cut on top of the previous $170, for a total decline of $470.

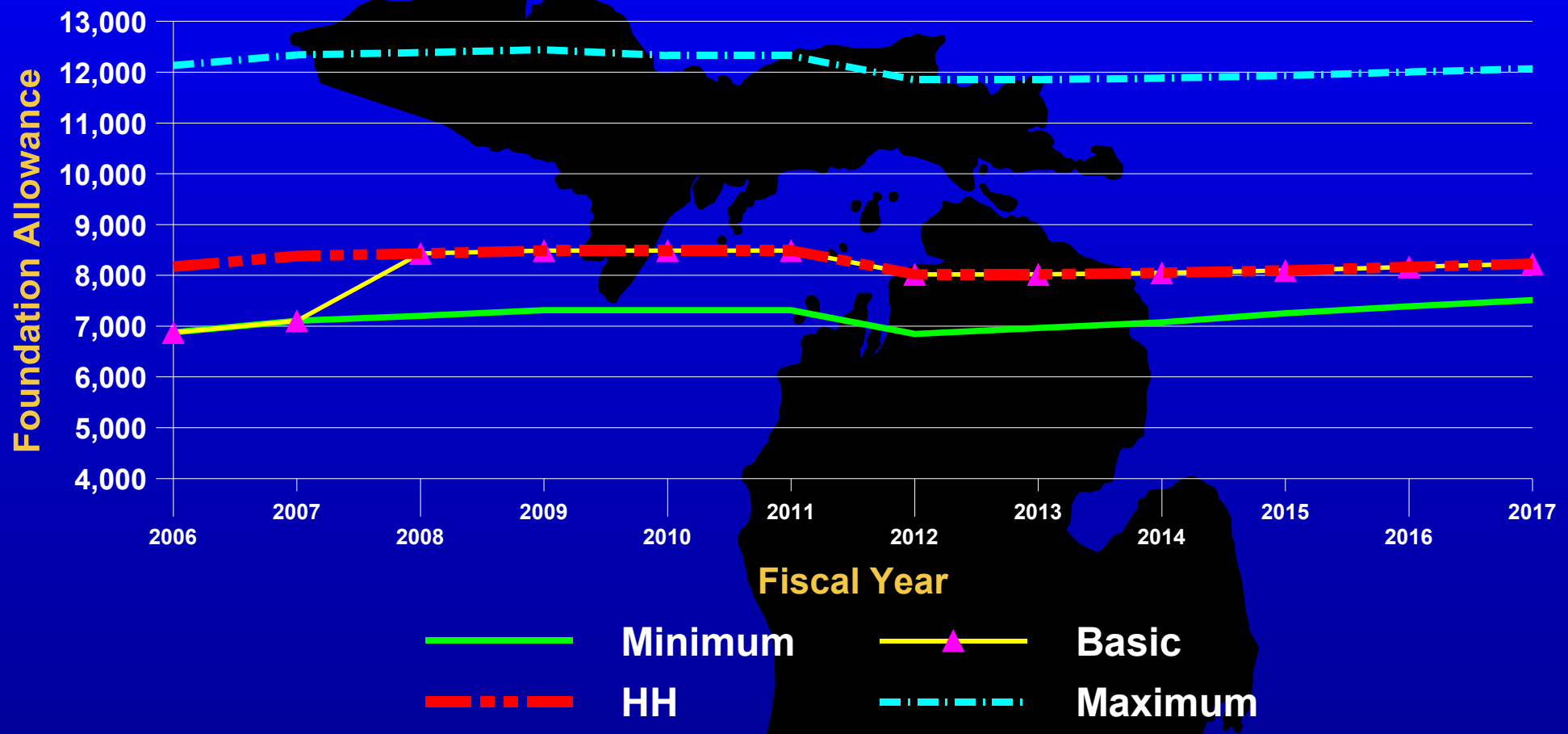
Basic Foundation Allowance

Fiscal Year	Dollar Increase
1994-1995	n/a
1995-1996	153
1996-1997	155
1997-1998	154
1998-1999	0
1999-2000	238
2000-2001	300
2001-2002	300
2002-2003*	200
2003-2004*	0
2004-2005	0
2005-2006	175
2006-2007	210
2007-2008	48
2008-2009	56
2009-2010**	0
2010-2011**	0
2011-2012	-470
2012-2013	0
2013-2014	30
2014-2015	50
2015-2016	70
2016-17	60

*Proration of approximately $74 per pupil occurred in each of these years, which statutorily did not reduce the foundation allowance. Districts were allowed to choose how to absorb the cut. Funding was restored in 2004-2005.

Change in Foundation Allowance Over Time

Shrinking Gap Between '95 and '00, and Again Since '08 When the Basic was Reset to the Hold Harmless (HH)

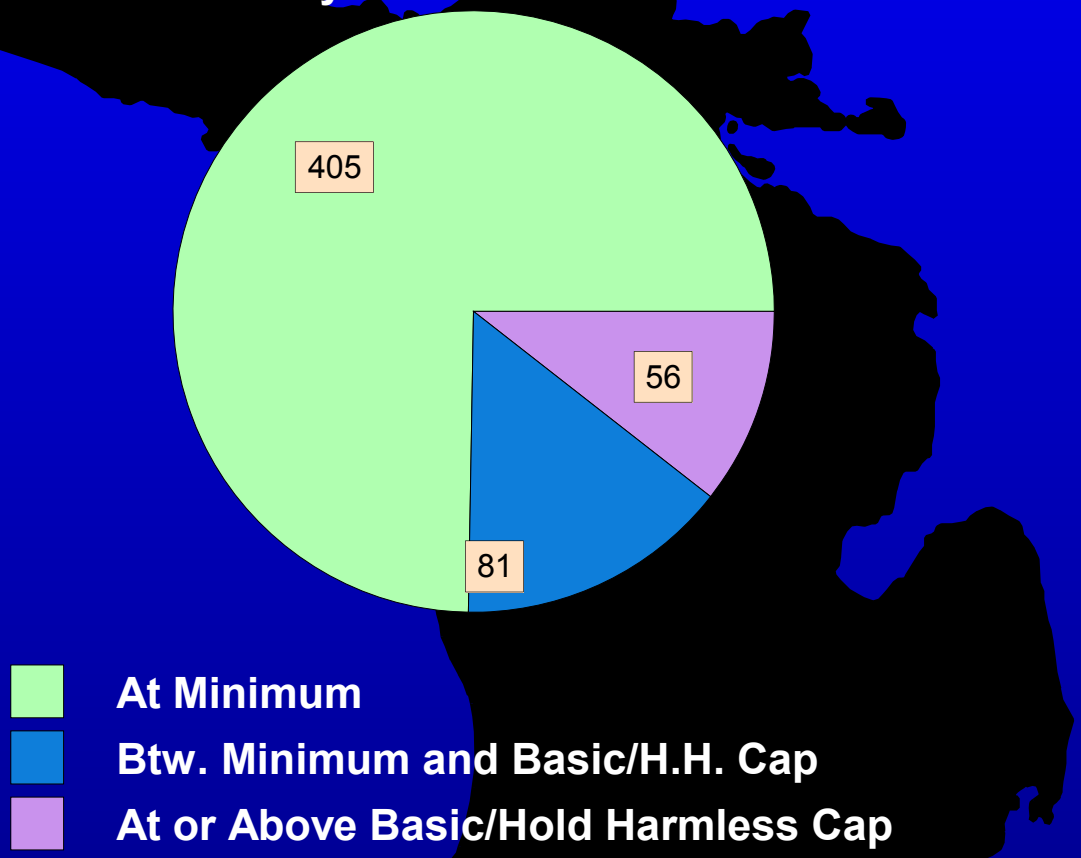


Minimum	6,875	7,108	7,204	7,316	7,316	7,316	6,846	6,966	7,076	7,251	7,391	7,511
Basic	6,875	7,108	8,433	8,489	8,489	8,489	8,019	8,019	8,049	8,099	8,169	8,229
HH	8,175	8,385	8,433	8,489	8,489	8,489	8,019	8,019	8,049	8,099	8,169	8,229
Maximum	12,129	12,339	12,387	12,443	12,324	12,324	11,854	11,854	11,884	11,934	12,004	12,064

2016-17 Foundation Allowances

Three Groupings of Local Districts' Per-Pupil Funding Excl. Equity
(excludes Charter Schools)

Numbers of Local Districts by 2016-17 Foundation Allowance Groupings



At Minimum	$7,511	405
Btw. Minimum and Basic/H.H. Cap	$7,512-$8,228	81
At or Above Basic/Hold Harmless Cap	At or Above $8,229	56

Charter Schools

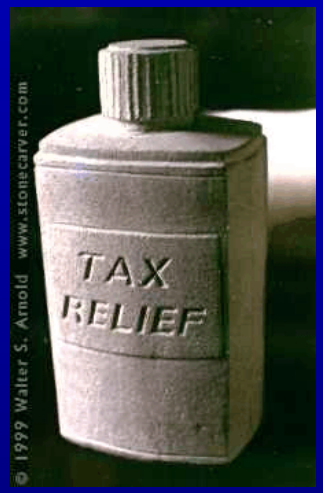
- Charter Schools in Michigan are paid entirely with State funds. Charters do not have physical property boundaries and therefore do not levy mills for a local revenue collection. A charter school receives a foundation allowance equal to the lesser of the per-pupil funding of the school district in which the PSA is located, or the PSA Maximum Foundation ($7,511 for FY 2016-17).

- Charter Schools are not allowed to ask for debt millage in Michigan, and must finance capital projects out of operating revenues.

- Including the EAA, in FY 2016-17, there are 300 operating charter schools, with pupil memberships totaling more than 152,000, or 10% of the total students enrolled in Michigan schools on a full-time basis.

Part III Summary: How has School Finance Changed with Proposal A?

- First and foremost, Proposal A was designed to lower Property Taxes - we now have higher sales, use, and cigarette taxes, and a new real estate transfer tax to offset lower property taxes.
- Second, Proposal A raised the lowest per-pupil districts to a “basic” level of funding.
- Third, Proposal A tied funding to a per-pupil concept, rather than the Property Tax basis.



Part IV

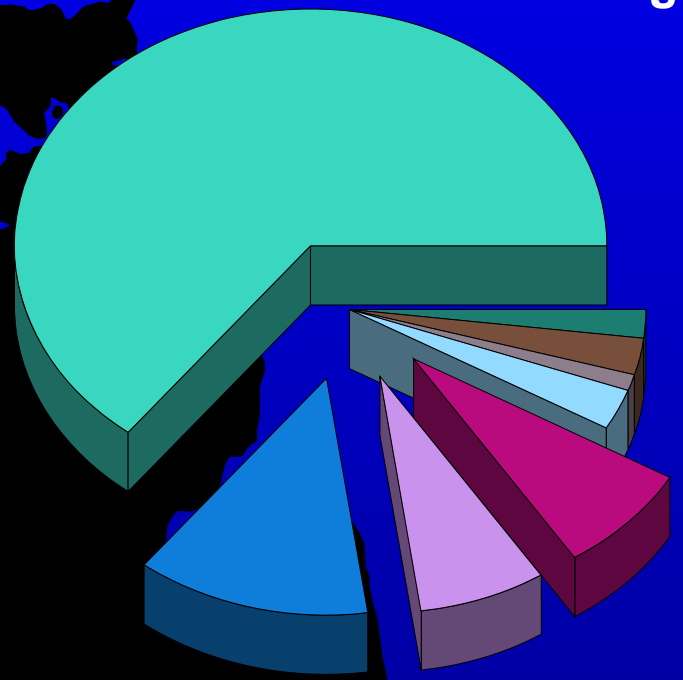
Now and the Future: Some Recurring Questions in School Finance

- Districts above the Hold Harmless cap generally have not received inflationary increases and, though "wealthier" on a per-pupil basis, typically have smaller fund balances. Section 20j operational funding was vetoed in FY 2009-10, further exacerbating the issue. 'Out-of-formula' districts (those whose local revenue exceeds their foundation allowance) receive no State increases.
- Declining Enrollment districts: since funding is tied to pupils, what happens to a district with a shrinking pupil base? There is a minimum level of funding necessary to operate district and pupil counts are not known until October.
- Fiscal year of State doesn't align with districts' fiscal years, leading to cash flow borrowing costs. State begins paying in October, but school year begins in July.
- Inequities in taxable values of similar homes, dependent on when last sold (i.e., longer in same house, lower taxes). This is the so-called "pop-up" issue. Empty nesters sometimes now stay in the home.
- Probable future discussions - consolidation, class sizes, busing, sales tax stability, sinking fund uses.
- Continued use of School Aid Fund Revenue to Partially support Postsecondary Budgets (higher education and community colleges)? Nearly $500 million annually.
- MPSERS - Rate cap, assumed rates of return.

Facts and Figures

- For enacted FY 2016-17, the total K-12 budget is $14.2 billion of which $1.8 billion is Federal aid, and the remaining $12.4 billion is State funding. (Local revenues are not included here.)
- Foundation Allowance payments make up roughly 65% of the K-12 budget. Federal grants are 13%, State Special Education is 7%, State MPSERS costs are 8%, At-Risk funding makes up 3%, Early Childhood makes up 2%, and other items account for the remainder of the budget.
- In 2017-18, there will be an estimated 1,330,000 FTEs in 542 Local School Districts and 152,000 FTEs in more than 300 Charter Schools.

FY 2016-17 School Aid Budget



- Foundation Payments
- Federal Grants
- State Special Education
- MPSERS/Retirement State Costs
- At-Risk Funding
- Debt Service/Cash Flow Costs
- Other
- Early Childhood Funding