

**SENATE FISCAL AGENCY  
 MEMORANDUM**

**DATE:** July 28, 2006  
**TO:** Members of the Senate  
**FROM:** Kathryn Summers-Coty, Chief Analyst  
**RE:** Explanation of the K-16 Coalition for Michigan's Future Funding Initiative and Revised Cost Estimates using May 2006 U.S. CPI Updated Figures - REVISED

On February 21, 2006, a broad coalition of education interest groups from across the State filed with the Secretary of State signatures to trigger the process of enacting an initiative law to provide guaranteed future funding increases in the State budget for K-12 school districts, community colleges, and universities. This memorandum provides an overview of the initiative law process, a discussion of the content found in the initiative (commonly referred to as the "K-16 funding initiative"), and an analysis of the potential impact of the K-16 funding initiative on the fiscal year (FY) 2006-07 State budget as appropriated in conference reports passed by the Legislature on July 26<sup>th</sup>.

**INITIATIVE LAW PROCESS**

The State Constitution of 1963 (Article II, Section 9) provides a process for the citizens of the State to initiate a change in State law. The constitutional process requires petitions signed by not less than 8.0% of the total vote cast for all candidates for Governor in the last preceding general election at which a Governor was elected. Based on the 2002 general election, this places the minimum signature requirement for an initiative law at 254,206.

The Secretary of State reviewed the petition signatures filed by the K-16 funding coalition on February 21, 2006, and determined that a valid number of signatures had been filed. The Board of State Canvassers certified the petition and the proposed change in State law was forwarded to the Legislature.

The Legislature was presented with the proposed initiative law on June 5<sup>th</sup>, and had 40 session days (including all calendar days Sunday through Saturday until sine die) to enact or reject the proposed law. Since the Legislature took no action on the proposed initiative within the 40-day period (which ended July 15<sup>th</sup>), the initiative will be submitted to the voters at the November 2006 general election. If the voters approve the initiative at the general election, the law will take effect, and will not be subject to the Governor's veto power.

**CONTENT OF K-16 FUNDING INITIATIVE**

To summarize, the initiative requires the following funding levels beginning in FY 2006-07:

- 1) Inflationary bottom-line spending increases in K-12, community colleges, and higher education, using FY 2004-05 funding levels on which to apply two years' inflation.

- 2) For K-12: declining enrollment three-year pupil blend for all districts, inflationary increase in the basic foundation allowance, closing the foundation allowance gap by \$300 over six years, and inflationary increases in at-risk, intermediate school district (ISD) operations, and special education.
- 3) Capping local contributions to the Michigan Public School Employees Retirement System (MPSERS) at the lesser of 80.0% of the actual retirement rate or 14.87% applied to payroll, requiring the State to pay the difference between the local contribution and the actual retirement rate.

The first section requires an inflationary increase for FY 2006-07 in gross State spending for K-12 from the 2004-05 fiscal year, and an inflationary increase in gross appropriations for community colleges and higher education as found respectively in Public Acts 358 and 352 of 2004. The consensus estimate of inflation as measured by the U.S. Consumer Price Index and reached at the May 2006 Consensus Revenue Estimating Conference is 6.5% over that two-year period. The necessary baseline increase for all three components (K-12, community colleges, and higher education) is estimated at \$180.3 million above the gross appropriation levels found in conference reports adopted by the Legislature for those budgets.

The second portion of the petition requires specific "guarantees" in funding. These guarantees include an inflationary increase in the basic foundation allowance, Proposal A obligation payment, discretionary payment, At-Risk grant, special education funding, and ISD operational funding. The Legislature's FY 2006-07 School Aid budget sets the basic foundation allowance at \$7,085; the initiative would require an additional \$51 per pupil to meet the inflationary increase requirement, bringing the basic foundation allowance to \$7,136. Also, the initiative includes a "declining enrollment" provision for all school districts. In this guarantee, an average of the prior three years' pupil membership blends, rather than the current-year membership blend alone, would be the basis for State aid payments, provided the three-year blend yielded a higher pupil number. Finally, on the operational funding side, the initiative contains a provision to reduce the State funding gap between the basic foundation allowance and the maximum foundation allowance (currently \$1,300) to \$1,000 over a period of six years. This analysis assumes the \$300 gap closure would occur in equal \$50 increments over each of the next six years.

- Note: The Legislature's increase in gross baseline funding for K-12, combined with the dollars available in "discretionary" or "nonrequired" categoricals appropriated in the Legislature's K-12 budget would provide sufficient funding to pay for the specific funding "guarantees" listed above **provided that** some of the existing School Aid discretionary categoricals were reduced from their Conference report FY 2006-07 level and new items in the Legislature's budget were not funded. In other words, existing and new program funds (e.g., Adult Education, School Readiness, or Middle School Math grants) could be used to offset the costs found in the specific funding guarantees required in the initiative. However, if the K-16 costs were simply added *on top of* the Legislature's School Aid budget, then the costs of funding all of the Legislature's initiatives *plus* the K-16 requirements would be \$141.7 million more than the \$180.3 million noted above, or \$322.0 million.

Turning to the retirement funding, the local portion of the contributions made by districts, ISDs, community colleges, and participating universities into the Michigan Public School Employees Retirement System would be capped at the lesser of 80.0% of the actual retirement rate or 14.87% (the FY 2004-05 rate) applied to payroll; the State would pay the difference to the MPSERS. The FY 2006-07 rate for K-12 and community colleges estimated in the Legislature's School Aid budget is 17.74%, meaning the local contribution would be capped at 14.19% of payroll and the State would have to pay 3.55% of payroll, estimated at \$371.9 million.

For participating universities, the total cost to be paid into the retirement system is estimated at \$44.4 million, which equates to 22.01% of payroll. Thus, the participating universities' contribution to the MPSERS would be capped at 14.87%, and the State contribution to the MPSERS for participating universities is estimated at 7.14% of payroll, for a State cost of \$14.4 million. Combining the State costs for K-12, community colleges, and universities yields a total estimated retirement cost of \$386.3 million.

**FISCAL IMPACT OF K-16 FUNDING INITIATIVE**

Table 1 shows for K-12, community colleges, and higher education the estimated required operational and MPSERS costs to the State in FY 2006-07, compared with the Legislature's recommended appropriation levels in those three budgets for FY 2006-07. As mentioned above, the cost reflected in Operations for K-12 uses much of the Legislature's recommended FY 2006-07 appropriations in **nonrequired** categoricals to offset the **mandated** costs of the K-16 proposal.

**Table 1**

| <b>Estimated Operational<sup>1)</sup> and MPSERS Costs in FY 2006-07<br/>           Compared with Legislature's Proposed FY 2006-07 Gross Appropriations<br/>           (Dollars in Millions)</b> |                |                               |                             |                |
|---|----------------|-------------------------------|-----------------------------|----------------|
|   | <b>K-12</b>    | <b>Community<br/>Colleges</b> | <b>Higher<br/>Education</b> | <b>Total</b>   |
| Operations <sup>1)</sup> .....  | \$153.4        | \$14.4                        | \$12.5                      | \$180.3        |
| MPSERS .....  | 352.9          | 19.0                          | 14.4                        | \$386.3        |
| <b>Total .....</b>  | <b>\$506.3</b> | <b>\$33.4</b>                 | <b>\$26.9</b>               | <b>\$566.6</b> |

1) Operations estimate for K-12 assumes eliminating new items and reducing some existing discretionary (i.e., nonobligational or discretionary) categoricals in the FY 2006-07 Legislature's K-12 budget below the levels appropriated for FY 2006-07. Also, "Operational" or "Operations" means standard operations funding plus any other State appropriations in the three budgets.

Table 1 indicates a total cost to meet the requirements of the initiative petition, combining K-12, community colleges, and higher education, of \$566.6 million above the Legislature's FY 2006-07 recommended gross appropriations. Of that total, 68.2% is represented by the required State contribution of the MPSERS retirement rate, and 31.8% devoted to operational funding costs.

For years beyond FY 2006-07, it is likely that the MPSERS component of the K-16 funding initiative would comprise the bulk of the costs to the State. Once the base "operational" funding floors for K-12, higher education, and community colleges were established and funded in FY 2006-07, State revenue in FY 2007-08 and beyond, at least in the School Aid Fund, likely would increase at least by the rate of inflation and could pay for the required inflationary operational increases. Thus, the additional cost of the initiative in FY 2007-08 probably would be less than the \$566.6 million estimated for FY 2006-07, but would depend upon the amount of the State contributions required to be paid to the MPSERS. In FY 2007-08 and beyond, retirement costs would continue to be a financial burden on the State as the MPSERS rate and participating entities' payrolls rose.

Attached is a detailed spreadsheet with each aspect of the initiative's financial requirements estimated for FY 2006-07. If you have any questions, please do not hesitate to call.

/kjh

Attachment

c: Gary S. Olson, Director  
Ellen Jeffries, Deputy Director

**Estimated K-16 Initiative Petition Costs in FY 2006-07  
Compared with Legislature's FY 2006-07 Adopted Conference Report Appropriation Levels**

| <b>OPERATIONS*</b>   | <b>K-12</b>             | <b>Community Colleges</b> | <b>Higher Education</b> |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
|--|-------------------------|---------------------------|-------------------------|----------------------|---------------|---------------------|------------|---|------------|---------|------------|----------------|-----------|-----------------------------|----------------------|
| FY 2004-05 Base  | \$11,113,522,200        | \$285,747,000             | \$1,690,150,500         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| FY 2006-07 Inflationary Increase:<br>6.5% Applied to FY 2004-05 Base   | +<br><u>722,378,943</u> | +<br><u>18,573,555</u>    | +<br><u>109,859,783</u> |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| <b>Total FY 2006-07<br/>Estimated Budgets w/ All Requirements</b><br>(see below for detail on Specific Requirements)   | 11,835,901,143          | 304,320,555               | 1,800,010,283           |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| FY 2006-07 Conference Reports  | minus<br>11,682,508,200 | minus<br>289,879,400      | minus<br>1,787,491,300  |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| <b>Additional Spending Required Above<br/>FY 2006-07 Conference Reports</b>  | <b>\$153,392,943</b>    | <b>\$14,441,155</b>       | <b>\$12,518,983</b>     |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| <p><u>Specific K-12 Requirements in FY 2006-07 above Conference Report</u><br/>           Costs associated with meeting all specific requirements:<br/>           These costs would replace the \$153.4 million above ONLY IF<br/>           no other categorical School Aid funding were used to offset K-16 costs.</p> <table border="0"> <tr> <td>Declining Enrollment</td> <td>\$179,410,000</td> </tr> <tr> <td>Foundation Increase</td> <td>84,100,000</td> </tr> <tr> <td>Closing Gap (assumed \$50 per year for six years)</td> <td>13,800,000</td> </tr> <tr> <td>At-Risk</td> <td>15,173,000</td> </tr> <tr> <td>ISD Operations</td> <td>2,641,800</td> </tr> <tr> <td><b>Total Specific Costs</b></td> <td><b>\$295,124,800</b></td> </tr> </table> |                         |                           |                         | Declining Enrollment | \$179,410,000 | Foundation Increase | 84,100,000 | Closing Gap (assumed \$50 per year for six years) | 13,800,000 | At-Risk | 15,173,000 | ISD Operations | 2,641,800 | <b>Total Specific Costs</b> | <b>\$295,124,800</b> |
| Declining Enrollment   | \$179,410,000           |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| Foundation Increase  | 84,100,000              |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| Closing Gap (assumed \$50 per year for six years)  | 13,800,000              |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| At-Risk  | 15,173,000              |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| ISD Operations   | 2,641,800               |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| <b>Total Specific Costs</b>  | <b>\$295,124,800</b>    |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |
| <p><b>\$180,353,081</b><br/>           Total Estimated Operations Cost: K-12+Community Colleges+Higher Education</p>   |                         |                           |                         |                      |               |                     |            |   |            |         |            |                |           |                             |                      |

| <b>MPSERS</b>   | <b>K-12</b>          | <b>Community Colleges</b> | <b>Higher Education</b> |
|---|----------------------|---------------------------|-------------------------|
| Local Contributions Capped at the Lesser of 80% of the retirement rate, or 14.87%.  |                      |                           |                         |
| Estimated FY 2006-07 Payrolls<br>Increased FY 2004-05 payroll by 3% yearly  | \$9,940,585,822      | \$535,648,410             | \$201,677,090           |
| FY 2006-07 K-12 and Community Colleges Rate is 17.74%; University Rate estimated at 22.01%.<br>K-12 District and CC share 14.19%; State share 3.55%<br>University share estimated at 14.87%; State share estimated at 7.14% |                      |                           |                         |
| State Cost:   | <b>\$352,890,797</b> | <b>\$19,015,519</b>       | <b>\$14,398,752</b>     |
| <p><b>\$386,305,068</b><br/>           Total Estimated Retirement Cost: K-12+Community Colleges+Higher Education</p>  |                      |                           |                         |

| <b>Total Petition Language Estimated Cost - Operations plus MPSERS</b>                 | <b>K-12</b>          | <b>Community Colleges</b> | <b>Higher Education</b> |
|--|----------------------|---------------------------|-------------------------|
| FY 2006-07 Costs Above Conference Reports  | \$506,283,740        | \$33,456,674              | \$26,917,735            |
| <b>Total Operations and MPSERS for K-12, Community Colleges, and Higher Education:</b> | <b>\$566,658,148</b> |                           |                         |

\* Throughout the table, "Operations" means standard operations funding plus any other appropriations in the budgets that may not be strictly "operational".

K-12 Conference Report is Senate Bill 1095 (CR-1\*); Community Colleges Conference Report is Senate Bill 1082 (CR-1); Higher Education Conference Report is Senate Bill 1088 (CR-1)