

DATE: July 27, 2006

TO: All Interested Parties

FROM: Mary Ann Cleary
 Kyle Jen
 Bethany Wicksall
 Viola Wild

RE: Summary and FY 2006-07 Cost Analysis of the K-16 Ballot Initiative

OVERVIEW

In very general terms, the K-16 Initiative would amend Michigan's School Aid Act in the following manner:

- Provide annual inflationary increases for
 - K -12 operations.
 - Specific provisions within the K-12 budget.
 - Higher Education and Community Colleges.
- Diminish the impact of declining enrollment on school funding.
- Decrease the gap between the minimum (basic) foundation allowance and the state maximum foundation allowance.
- Shift responsibility for a portion of Michigan Public School Employees Retirement System (MPERS) contributions from local school districts, universities, and community colleges to the state.

For FY 2006-07, the K-16 Initiative would require additional funding—over the enrolled budget amounts—as described below:

	<u>Estimated Cost</u>
<u>K-12</u>	
Operations inflationary increase	\$153.4 million
MPERS state contribution	\$357.8 million
<u>Higher Education/Community Colleges</u>	
Inflationary increase	\$27.2 million
MPERS state contribution	<u>\$33.4 million</u>
TOTAL Minimum Required	\$571.8 million
Fund K-12 Section 12 and maintain current categoricals at enrolled levels	<u>\$127.1 million</u>
TOTAL Required Including Categoricals	\$698.9 million

SPECIFICS

More specifically, the K-16 Initiative would amend Michigan's School Aid Act in the following manner:

- Using FY 2004-05 as the base funding level, provide annual funding increases equal to the rate of inflation (defined as the U.S. Consumer Price Index) for K-12 schools, Community Colleges, and Higher Education (includes state universities and financial aid/grant programs).

Under the K-16 Initiative, FY 2006-07 appropriations for K-12, Community Colleges, and Higher Education would have to increase by a projected 6.5% (estimated rate of inflation) from the FY 2004-05 level.

- Provide annual increases for K-12 for specific sections within the School Aid Act (the foundation allowance itself and special education, at-risk, and Intermediate School District (ISD) operations funding).
- Fund K-12 school districts based on either a three-year average of student enrollment or the current annual pupil membership blend—whichever is higher—to diminish the funding impact of declining enrollment.
- Reduce the gap between the minimum (basic) foundation allowance and the state maximum foundation allowance from \$1,300 to \$1,000 between FY 2006-07 and FY 2011-12.
- Cap the retirement contribution for the Michigan Public School Employees Retirement System (MPSERS) at 14.87% or 80% (whichever is less) of the total retirement rate for K-12 districts, community colleges, and state universities—and require the state to pay the remaining portion. With a FY 2006-07 retirement rate estimate of 17.74%, the local portion would be 14.19% and the state portion would be 3.55%.

Because the seven universities that are part of MPSERS are billed directly for retiree health costs (rather than paying based on a percentage rate) and the universities pay a percentage of their nonmember payroll for unfunded liability costs, the impact of the initiative on state universities is less clear.

FISCAL IMPACT

For FY 2006-07, the K-16 Initiative would require an estimated \$571.8 million to \$698.9 million total in additional funding—over the FY 2006-07 enrolled budget amounts—for School Aid (SB 1095), Higher Education (SB 1088), and Community Colleges (SB 1082). This would represent a total increase of approximately \$1.0 billion over FY 2005-06 year-to-date appropriations; increases in fiscal years beyond FY 2006-07 are indeterminate at this time.

School Aid

The estimated FY 2006-07 total cost impact for School Aid is between \$511.2 million and \$638.3 million. This amount can be broken into two major pieces: an operational component (\$153.4 million to \$280.5 million) and a MPSERS component (\$357.8 million).

Operations

The operations component would require an increase in overall School Aid expenditures (Section 11) as well as increases for specific sections of the act (Section 12). The K-16 Initiative would require the total state appropriation in Section 11 to be increased annually, by the rate of inflation, from the FY 2004-05 base of \$11.114 billion. This would require an appropriation of almost \$11.836 billion for FY 2006-07, rather than the enrolled appropriation of \$11.683 billion—a total shortfall of approximately \$153.4 million. See Table 1 for more detail.

The K-16 Initiative would include a Section 12, which would require the foundation allowance, and a number of specific sections in the act, to increase annually—by the rate of inflation—from the FY 2004-05 base.

This would require a FY 2006-07 basic foundation allowance of \$7,136, which is \$51 per pupil higher than the current FY 2006-07 foundation allowance of \$7,085. This also would require increases in funding for special education, at-risk programs, and ISD operations.

The enrolled FY 2006-07 budget would fall short of fully funding the Section 12 requirements by about \$280.5 million. The overall budget would not necessarily need to increase by \$280.5 million, but the distribution of funds within the School Aid budget would require changes in order to fully fund the specified pieces.

Without additional funds, all other categorical programs in the School Aid budget would have to be eliminated (see Appendix A for a list of these programs and funding levels). To keep all programs fully funded in the FY 2006-07 budget, an increase of \$280.5 million in the total appropriation would be required. Table 1 shows differences between required and enrolled appropriations for each identified section.

Section 12 would also add two provisions not based on inflationary increases.

The first provision would pay districts a foundation allowance based on either a three-year average of their pupil membership or on the current annual basis—whichever is higher—to slow the funding decreases experienced by schools with declining enrollment. The total cost of this proposal would be approximately \$206.4 million. The FY 2006-07 enrolled budget does include \$27.0 million for two declining enrollment sections (Section 6(4)(y) and Section 29), which would contribute to this funding piece.

The second provision would require reducing the gap between the minimum (basic) foundation allowance and the state maximum foundation allowance from \$1,300 to \$1,000 by FY 2011-12—but the initiative does not define the mechanism by which, or an incremental time frame in which, this provision would have to be implemented. The FY 2006-07 budget does include \$20.0 million for an equity payment of \$23 per pupil for districts with a FY 2006-07 foundation of less than \$7,360, which would reduce the gap to \$1,277.

MPSERS

The K-16 initiative would cap the retirement contribution for MPSERS at 14.19% for K-12 districts and require the state to pay the other portion. With a FY 2006-07 retirement rate estimate of 17.74%, the state portion would be 3.55%—which would

require the state to contribute approximately \$357.8 million on an estimated K-12 payroll of almost \$10.1 billion.

Higher Education and Community Colleges

The estimated FY 2006-07 cost impact for Higher Education and Community Colleges totals \$60.6 million. This amount can be broken into two major pieces: an operational component (\$27.2 million) and a MPSERS component (\$33.4 million). See [Table 2](#) for more detail.

Operations

The operations component requires that the annual gross appropriations for both Higher Education and Community Colleges increase annually by the rate of inflation—beginning with FY 2004-05 as a base year. The required increase applies only to the total appropriation for each budget and does not require increases to specific lines.

For example, University and Community College operational funding would not necessarily have to increase if the requirement were met through increases to financial aid and grant programs. To meet the projected required increase, Higher Education funding would need to increase by \$12.7 million from the enrolled FY 2006-07 amount and Community College funding would need to increase by \$14.5 million from the enrolled FY 2006-07 amount.

MSPERS

The MPSERS component would require an estimated \$19.0 million for Community Colleges. The effect of the MPSERS component on the seven state universities in the system is difficult to assess; a scenario based on total MPSERS costs as a percentage of total payroll at those universities yields a cost estimate of \$14.4 million for FY 2006-07. This estimate is based on an effective payroll percentage of 22.2.

Questions regarding this information should be directed to the House Fiscal Agency.

Table 1: K-16 Initiative Estimated FY 2006-07 Costs: K-12 Estimate

	Requirement Initiative Language <u>FY 2006-07</u>	Enrolled SB 1095 <u>FY 2006-07</u>
<u>OPERATIONS COMPONENT</u>		
SECTION 11		
Requirements in Section 11		
FY 2004-05 Appropriations - Base Funding	\$11,113,522,200	
Adjustment for Increase in US CPI from CY 2004 to CY 2006* =6.5%	\$722,378,943	
FY 2006-07 Funding Floor (Minimum Funding)	\$11,835,901,143	\$11,682,508,200
Difference: Required Section 11 Minus Enrolled		\$153,392,943
SECTION 12		
Requirements in Section 12, increases in individual sections within the School Aid Act		
Section 20 Foundation Allowance inflationary increase (Foundation Allowance equals \$7,136 or \$436 per pupil increase)	\$339,100,000	\$256,550,000
Section 31a - At-Risk inflationary increase	\$20,423,000	\$5,150,000
Section 51a and 51c - Special Education inflationary increase	\$66,700,000	\$66,100,000
Section 81 - ISD Operations inflationary increase	\$5,050,637	\$2,408,800
Declining Enrollment (3 year-average)	\$206,400,000	\$27,000,000
Closing the gap by \$300 over 6 years	\$20,000,000	\$20,000,000
Total Estimated Cost to meet the individual requirements in the petition language	\$657,673,637	\$377,208,800
Difference: Required Section 12 Minus Enrolled		\$280,464,837
<i>Sections 11 and 12 funding requirements are not added together but each section requirement must be met for compliance. The minimum funding level in FY 2006-07 must be at least equal to the inflationary increase from 2004 to 2006, or 6.5% over the FY 2004-05 funding floor. Senate Bill 1095 for the foundation allowance is \$7,085.</i>		
<u>MPSERS COMPONENT</u>		
SECTION 147A		
Local Contributions Capped at the Lesser of 80% of the retirement rate or 14.87% (FY 2004-05 rate)		
Estimated FY 2006-07 MPSERS Payroll	\$10,084,130,176	\$10,084,130,176
State Portion: FY 2006-07 retirement rate is estimated at 17.74%; the District portion of the retirement rate is 14.192% which is 80% of the total rate and the State portion of the retirement rate is 3.548%	\$357,784,939	\$0
Difference: Required MPSEER Portion Minus Enrolled		\$357,784,939
TOTAL COST		
Total FY 2006-07 Estimated Cost above FY 2006-07 Enrolled		\$511,177,882

Notes: *CY 2006 US CPI based on estimate from May Consensus Revenue Conference.
Assumes conference report for Senate Bill 1095 is approved and signed without vetoes.

**Table 2: K-16 Initiative Estimated FY 2006-07 Costs:
Higher Education and Community College Estimate**

	<u>Higher Education</u>	<u>Community Colleges</u>	<u>Total</u>
<u>OPERATIONS COMPONENT</u>			
FY 2004-05 Enacted Appropriations*	\$1,690,150,500	\$285,747,000	\$1,975,897,500
Adjustment for Projected Increase in US CPI from CY 2004 to CY 2006**	<u>\$110,052,150</u>	<u>\$18,606,078</u>	<u>\$128,658,228</u>
Required FY 2006-07 Appropriations under K-16 Initiative	\$1,800,202,650	\$304,353,078	\$2,104,555,728
% Change from FY 2004-05 Enacted	6.5	6.5	6.5
FY 2006-07 Enrolled Appropriations	\$1,787,491,300	\$289,879,400	\$2,077,370,700
Difference: Required FY 2006-07 Minus FY 2006-07 Enrolled	\$12,711,350	\$14,473,678	\$27,185,028
% Change from FY 2006-07 Enrolled	0.7	5.0	1.3

*Includes all line items in both budgets--operations plus grants/financial aid/etc.

**CY 2006 US CPI based on estimate from May Consensus Revenue Conference

MPSERS COMPONENT

Estimated FY 2006-07 MPSERS Payroll	\$119,700,000	\$535,860,590	\$655,560,590
Universities: Based on projected effective rate of 22.20%*; state portion=7.33%	\$14,400,000	\$19,023,051	\$33,423,051
Comm. Colleges: Based on actual rate of 17.74%; state portion=3.55%			

*Effective rate calculated based on total payroll (rather than just member payroll) since a portion of MPSERS costs are paid based on nonmember payroll

TOTAL COSTS

Total FY 2006-07 Estimated Costs above FY 2006-07 Enrolled	\$27,111,350	\$33,496,729	\$60,608,079
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Note: Assumes conference reports for Senate Bills 1082 and 1088 are approved and signed without vetoes.

Appendix A
FY 2006-07 State Funded School Aid Categoricals
(Dollars in Millions)

	<u>Enrolled Amount</u>
Cash Flow Borrowing Costs	\$22,800.0
Court-Placed Pupils	\$8,000.0
Juvenile Detention Facility Programs	\$3,000.0
Challenge Program	\$1,253.1
Adolescent Health Centers	\$3,743.0
Hearing and Vision Screening	\$5,150.0
Mercy Education Project	\$100.0
Children of Incarcerated Parents	\$1,875.0
School Breakfast Program	\$9,625.0
ECIC Collaborative Grants	\$1,000.0
Early Childhood Grants	\$1,750.0
School Readiness – District program	\$78,800.0
Great Parents Great Start ISD programs	\$5,000.0
School Readiness – Competitive program	\$12,250.0
Book a Month Program	\$500.0
Early Intervention Program	\$400.0
Bilingual Education	\$2,800.0
Special Education Evaluation Lending Library	\$250.0
Conductive Learning Center	\$250.0
Advanced & Accelerated Program	\$285.0
International Baccalaureate Grants	\$250.0
Vocational Education	\$30,000.0
ISD Voc. Ed Millage Equalization	\$9,000.0
Health/Science Middle College Program	\$2,000.0
Precollege Engineering	\$780.1
Bus Driver Safety Instruction	\$1,625.0
School Bus Inspections	\$1,340.0
Center for Educational Performance (CEPI)	\$2,350.0
Michigan Virtual High School (MVHS)	\$2,750.0
Web Based Testing	\$1,000.0
Math/Science Centers	\$3,500.0
Engineering Michigan's Future - District Funding	\$20,000.0
Automatic External Defibrillators	\$100.0
Financial Emergency District Funding	\$125.0
School Building Security Maps	\$350.0
Positive Behavioral Support Program	\$300.0
FIRST Robotics	\$150.0
MEAP Testing	\$19,500.0
Adult Education	\$24,000.0

Note: Without additional funds, these categorical programs in the School Aid budget would have to be eliminated.