

# FISCAL BRIEF



## BASICS OF THE FOUNDATION ALLOWANCE—FY 2018-19 UPDATE

Bethany Wicksall, Deputy Director  
Jacqueline Mullen, Fiscal Analyst  
Samuel Christensen, Fiscal Analyst  
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### FAST FACTS

- Proposal A of 1994 created a per-pupil funding method, including both state and local funds, known as the foundation allowance to fund general school operations.
- In FY 2018-19, state funding for foundation allowances totals \$9.4 billion, almost two-thirds of the School Aid budget.
- The current **Minimum** foundation is \$7,871.
- The current **State Maximum** guaranteed foundation is \$8,409.
- Since Proposal A, annual increases are often determined by a **2x formula** to reduce disparity in per-pupil funding (the equity gap) by increasing the Minimum twice as much as the State Maximum.
- Since Proposal A, the equity gap has decreased from \$2,300 to \$538.

### INTRODUCTION

Proposal A of 1994 created a new mechanism for providing state funding to school districts in Michigan. Called the foundation allowance, each school district is allocated a per-pupil amount—in combined state and local funds—to support school operations. State funding for foundation allowances totals \$9.4 billion for fiscal year (FY) 2018-19, nearly two-thirds of the total School Aid budget. Local school operating property taxes, which do not flow through the state budget, will add an estimated \$2.6 billion. Foundation allowances represent the majority of general school operating funding. The method for determining initial foundation allowances and annual funding increases is described in detail below.

### FOUNDATION ALLOWANCE LEVELS

The foundation allowance was first used in FY 1994-95. Initial foundation allowances were based on the amount of revenue per pupil each school district received during FY 1993-94 (prior to implementation of Proposal A) in combined state and local funds. This figure included local property tax revenue levied for school operating purposes, state aid under the prior guaranteed tax base method, and certain categorical funding in FY 1993-94. Among K-12 districts, this FY 1993-94 baseline funding varied considerably, from a low of \$3,398 to a high of \$10,294, largely reflecting variances in local property tax values and millage rates.

Proposal A created three main foundation allowance levels:

- The **Minimum** foundation allowance, set initially at \$4,200, to create a floor below which no district would fall.
- The **Basic** foundation allowance, set initially at \$5,000, to create a goal to which the Proposal A drafters hoped to bring all districts over time.
- The **State Maximum** guaranteed foundation allowance, set initially at \$6,500, to create a ceiling above which the state would not contribute. (Certain districts, called **Hold Harmless** districts, have foundation allowances higher than the State Max using additional local revenue; see **Hold Harmless and Out-of-Formula** districts below.)

## CALCULATING FOUNDATION ALLOWANCE ANNUAL INCREASES

District foundation allowances are calculated each year by adding incremental dollar increases (or decreases) to the previous fiscal year's amount. The primary mechanism used to do this is the basic foundation allowance (the Basic).

Originally set at \$5,000 per pupil<sup>1</sup>, the Basic was a target per-pupil funding level that the creators of Proposal A intended all districts to reach one day. However, rather than immediately bringing all districts up to the Basic, the lowest revenue districts first were raised to a minimum foundation allowance (the Minimum), initially set at \$4,200.

The Legislature and the Governor determine the increases in the Basic and Minimum each year in the School Aid budget (compiled in Article I of State School Aid Act). Initially, increases were calculated with a statutory formula—often referred to as the *2x formula*—that allocated for districts at the Minimum an increase equal to twice the amount of the increase in the Basic. Under the 2x formula, foundation allowances above the Basic were increased by the same amount as the Basic, and foundation allowances between the Minimum and the Basic were increased incrementally on a sliding scale calculated by the formula.

**Table 1: Annual 2x Formula Increases**

Foundation Level	Annual Increase
Equal to or Greater than the Basic	x
Between the Minimum and the Basic	$x < \text{Incremental Increase} < (2 * x)$
At the Minimum	$(2 * x)$

Doubling the increase to districts at the Minimum diminished the inequity in per pupil funding among school districts, thus accomplishing one of the primary goals of Proposal A. By FY 1999-2000, using the 2x formula, the Minimum caught up to the Basic level of \$5,700, and the difference between the Minimum and the State Maximum Guarantee (the State Max) had decreased to \$1,500.

From FY 2000-01 to FY 2006-07, all school districts received the same dollar increase in their foundation allowance (except in cases of equity payments—added payments at the Minimum to further diminish the difference between it and the State Max). For example, if the Basic increased by \$200 from the previous year, every school district received a \$200 increase in its foundation allowance.

In FY 2007-08, the Legislature reestablished the use of the 2x formula, retargeting the Basic at the State Max, thus creating a new goal of completely eliminating the equity gap between the Minimum and the State Max. However, beginning in 2010, foundation allowances were reduced for three consecutive years due to reduced school aid revenues (initially and unofficially through Sec. 11d reductions due to the recession, and then officially through subsequent tax policy changes in FY 2011-12). Since FY 2012-13, the Governor and the Legislature have used a mix of across-the-board increases, equity payments to districts at the Minimum, and 2x formula increases to try to reach the more recent goal of altogether eliminating the equity gap.

For FY 2018-19, using 2x formula increases ranging from \$120 at the top to \$240 at the bottom, the Minimum increased to \$7,871 and the State Max (and Basic) increased to \$8,409. The gap between the two has been reduced to \$538. [Table 2](#) and [Figure 1](#) below displays the history of the growth in the various levels of the foundation allowance.

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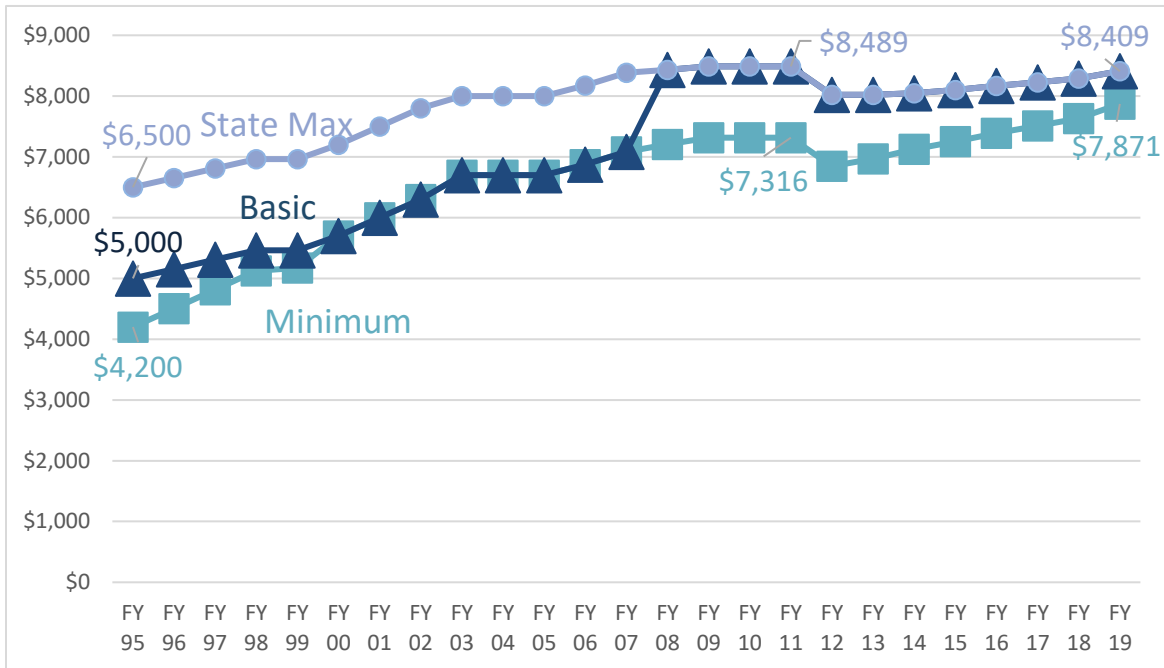
<sup>1</sup> Payments are based on a proportion of full-time-equated pupils enrolled in the district on the October count date in the current school year and the February count date in the prior school year, rather than headcounts. The proportional weight given to each count date has changed over time, but since FY 2015-16 is equal to 90% of the October count plus 10% of the prior February count.

**Table 2: History of Foundation Allowance Growth**

Fiscal Year	Minimum	Basic	State Max	Change in Minimum	Change in Basic & State Max	Difference Between Minimum & State Max
1994-95	\$4,200	\$5,000	\$6,500	NA	NA	\$2,300
1995-96	\$4,506	\$5,153	\$6,653	\$306	\$153	\$2,147
1996-97	\$4,816	\$5,308	\$6,808	\$310	\$155	\$1,992
1997-98	\$5,124	\$5,462	\$6,962	\$308	\$154	\$1,838
1998-99	\$5,170	\$5,462	\$6,962	\$46	\$0	\$1,792
1999-00	\$5,700	\$5,700	\$7,200	\$530	\$238	\$1,500
2000-01	\$6,000	\$6,000	\$7,500	\$300	\$300	\$1,500
2001-02 <sup>1</sup>	\$6,500	\$6,500	\$7,800	\$500	\$300	\$1,300
2002-03	\$6,700	\$6,700	\$8,000	\$200	\$200	\$1,300
2003-04	\$6,700	\$6,700	\$8,000	\$0	\$0	\$1,300
2004-05	\$6,700	\$6,700	\$8,000	\$0	\$0	\$1,300
2005-06	\$6,875	\$6,875	\$8,175	\$175	\$175	\$1,300
2006-07 <sup>2</sup>	\$7,108	\$7,108	\$8,385	\$233	\$210	\$1,277
2007-08 <sup>3</sup>	\$7,204	\$8,433	\$8,433	\$96	\$48	\$1,229
2008-09	\$7,316	\$8,489	\$8,489	\$112	\$56	\$1,173
2009-10 <sup>4</sup>	\$7,316	\$8,489	\$8,489	\$0	\$0	\$1,173
2010-11 <sup>5</sup>	\$7,316	\$8,489	\$8,489	\$0	\$0	\$1,173
2011-12	\$6,846	\$8,019	\$8,019	(\$470)	(\$470)	\$1,173
2012-13	\$6,966	\$8,019	\$8,019	\$120	\$0	\$1,053
2013-14 <sup>6</sup>	\$7,076	\$8,049	\$8,049	\$110	\$30	\$973
2014-15 <sup>7</sup>	\$7,251	\$8,099	\$8,099	\$175	\$50	\$848
2015-16	\$7,391	\$8,169	\$8,169	\$140	\$70	\$778
2016-17	\$7,511	\$8,229	\$8,229	\$120	\$60	\$718
2017-18	\$7,631	\$8,289	\$8,289	\$120	\$60	\$658
2018-19	\$7,871	\$8,409	\$8,409	\$240	\$120	\$538

<sup>1</sup> The Minimum includes an equity payment of \$200, which was officially rolled into foundations in FY 2002-03.  
<sup>2</sup> In FY 2006-07, districts with a foundation below \$7,460 received an equity payment of up to \$23 per pupil, which was officially rolled into foundations in FY 2007-08.  
<sup>3</sup> In FY 2007-08, the Basic was raised to the state maximum and the original Proposal A (2x) formula was reestablished to increase foundations below the Basic at a faster rate than those at or above it.  
<sup>4</sup> While the statutory foundation allowance was not changed, the budget included a \$154 per pupil reduction under Sec. 11d.  
<sup>5</sup> While the statutory foundation allowance was not changed, the budget included a \$170 per pupil reduction under Sec. 11d.  
<sup>6</sup> The minimum foundation included an equity payment of \$50, which was officially rolled into foundations in FY 2014-15.  
<sup>7</sup> The minimum foundation includes an equity payment of \$125, which was officially rolled into foundations in FY 2015-16.

**Figure 1: The Minimum, Basic, and State Maximum Foundation Allowances**



### THE STATE/LOCAL FUNDING SPLIT

The total amount of revenue a district receives for its foundation allowance is derived by multiplying the number of general education pupils the district educates by its foundation allowance. For example, if a district with a foundation allowance of \$8,000 has 1,000 pupils, it would receive \$8.0 million in foundation allowance revenue (\$8,000 × 1,000). However, the state pays only a portion of this revenue: the amount remaining after subtracting the amount of local revenue that the district is expected to collect from nonhomestead property taxes.

Under Proposal A, school districts are expected to levy 18 mills (or the number of mills levied in 1993, whichever is less) on nonhomestead property<sup>2</sup>. For the purposes of determining the state portion of the foundation allowance, it is assumed that districts levy the full number of their expected mills.

Generally, the state portion of the foundation allowance equals:

$$\left( \begin{array}{l} \text{Pupils} \\ \times \\ \text{the lesser of either:} \\ \text{a district's foundation allowance} \\ \text{or} \\ \text{the State Max (\$8,409)} \end{array} \right) - \text{Assumed local nonhomestead property tax revenue}$$

<sup>2</sup> Nonhomestead property is all property other than a taxpayer’s principal residence or other limited types of exempt property under the Revised School Code: <http://legislature.mi.gov/doc.aspx?mcl-380-1211>. Generally, nonhomestead property includes commercial and industrial property, second homes, and rental homes.

Using our previous example, if a district with an \$8,000 foundation allowance and 1,000 pupils raises \$5.0 million in local revenue from its 18-mill nonhomestead property tax, the state would pay only \$3.0 million of the \$8.0 million. In this example, the state pays \$3,000 per pupil ( $\$3.0 \text{ million} \div 1,000 \text{ pupils}$ ) toward the district's \$8,000 foundation allowance and the local district pays \$5,000 per pupil. This state/local mix is different for every district and changes from year to year depending on the district's local nonhomestead taxable value growth and number of pupils. The variation in state/local share depends not so much on overall property values, but on the district's type of property and pupil density. A lakefront district with low levels of year-round residents and many second homes, will generate a higher local share. A residential suburb with little commercial or industrial property, will generate a lower local share.

## HOLD HARMLESS AND OUT-OF-FORMULA DISTRICTS

There are 43 **Hold Harmless** districts whose statutory foundation allowances exceed the State Max. Those districts had combined state and local revenues that exceeded the State Max when Proposal A was adopted. They are allowed to make up the difference in revenue between the State Max and their foundation allowance by levying additional local hold harmless millages<sup>3</sup>. However, not all of them do.

**Out-of-Formula** districts generate enough revenue from their local general operating nonhomestead millages to exceed their statutory foundation, and as such do not receive any state funds toward their foundation allowances.

Some districts are both hold harmless and out-of-formula. Currently there are the following:

- 24 Hold Harmless districts levy an additional millage.
- 5 Hold Harmless districts do not levy an additional millage, and so are effectively capped at the State Max, despite having a higher statutory foundation allowance.
- 14 Hold Harmless districts are also Out-of-Formula and generate enough local revenue to exceed their statutory foundation and therefore do not need to levy additional hold harmless millages.
- 31 Out-of-Formula districts receive local revenue equal to or exceeding their statutory foundation (which does not exceed the State Max).

## PUBLIC SCHOOL ACADEMIES (PSAs)

Originally, and until FY 2007-08, the foundation allowance for a PSA, or charter school, was the lesser of the following:

- The foundation allowance of the local district in which the PSA is located; or
- \$300 above the Basic.

Since reestablishing the 2x formula in FY 2007-08, the foundation allowance for a PSA has been the lesser of:

- The foundation allowance of the local district in which the PSA is located; or
- The maximum public school academy allocation (**PSA Max**).

The PSA Max is an amount adjusted annually under the 2x formula like any other district foundation allowance, based on the level of the highest PSA foundation allowance when the formula was restored. The PSA Max was \$7,580 from FY 2008-

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<sup>3</sup> A hold harmless district's state share is reduced by an amount equal to its former Sec. 20j payment (repealed MCL 388.1620j), which the district also may restore with hold harmless millage revenue. Sec. 20j was repealed in 2011, but had previously provided payments to hold harmless districts to allow their foundation allowances to grow at the same rate as the Basic in years when the Basic increase exceeded the rate of inflation. Otherwise, Sec. 1211 (MCL 380.1211) of the Revised School Code caps the growth rate of Hold Harmless district foundation allowances to the rate of inflation.

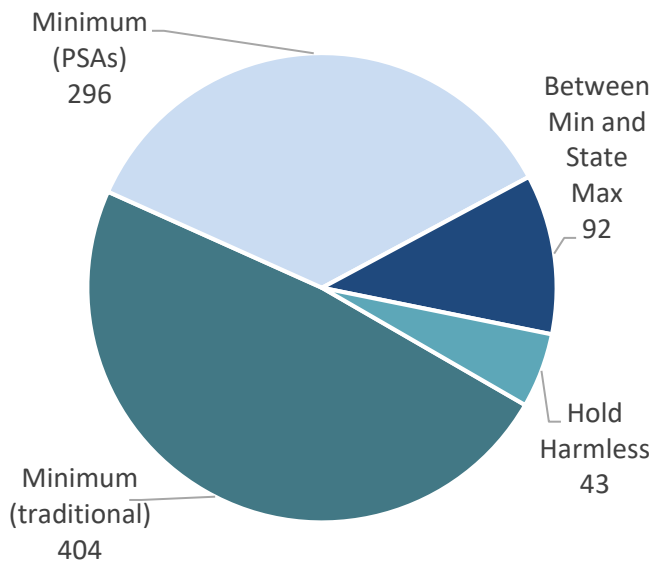
09 to FY 2010-11 but was reduced to \$7,110 for FYs 2011-12 and 2012-13. Given the equity payments that have significantly increased the Minimum in subsequent years, the Minimum caught up with the PSA Max in FY 2014-15, making them equal. Now all PSA foundations are equal to the Minimum, which was set at \$7,871 for FY 2018-19. PSAs do not levy local property taxes; therefore, the state funds 100% of their foundation allowances.

## DISTRIBUTION OF FOUNDATION ALLOWANCES

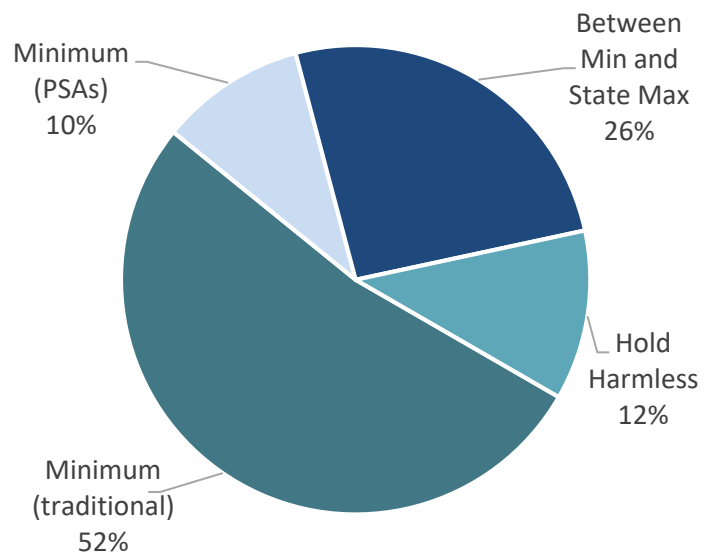
Over time, as the 2x formula and equity payments bring the Minimum closer to the State Max, an increasing number of districts and pupils are picked up by the Minimum. In FY 2018-19, 700 districts (both traditional and PSA), accounting for an estimated 62% of the total student population<sup>4</sup>, are at the Minimum out of a total of 835 districts. Figures 2 and 3 below show the current district and pupil distribution. Figures 4 and 5 on page 7 display the change in the distributions by district from FY 1994-95 to now. A current list of foundation allowances by school district may be found here:

[http://www.house.mi.gov/hfa/PDF/SchoolAid/SchAid\\_Data\\_School\\_District\\_Foundation\\_Allowances.pdf](http://www.house.mi.gov/hfa/PDF/SchoolAid/SchAid_Data_School_District_Foundation_Allowances.pdf)

**Figure 2: FY 2018-19 District Distribution**



**Figure 3: FY 2018-19 Pupil Distribution**



<sup>4</sup> Based on May 2018 Consensus Revenue Estimating Conference estimates.

Figure 4: FY 1994-95 Per Pupil Foundation

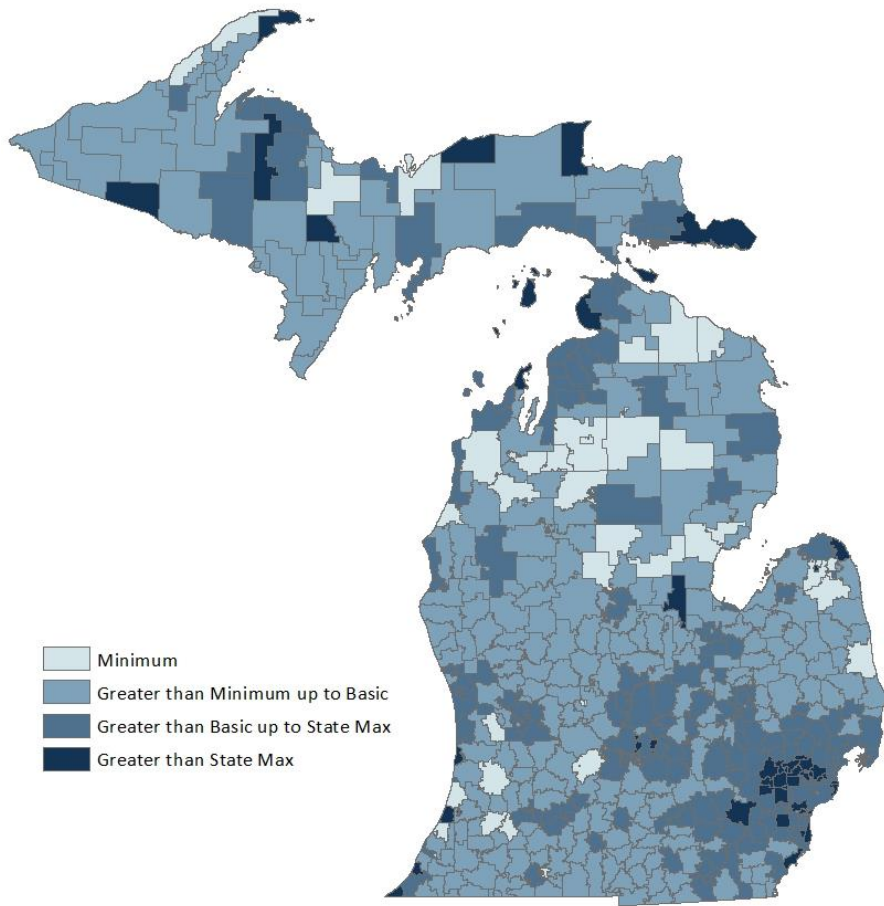
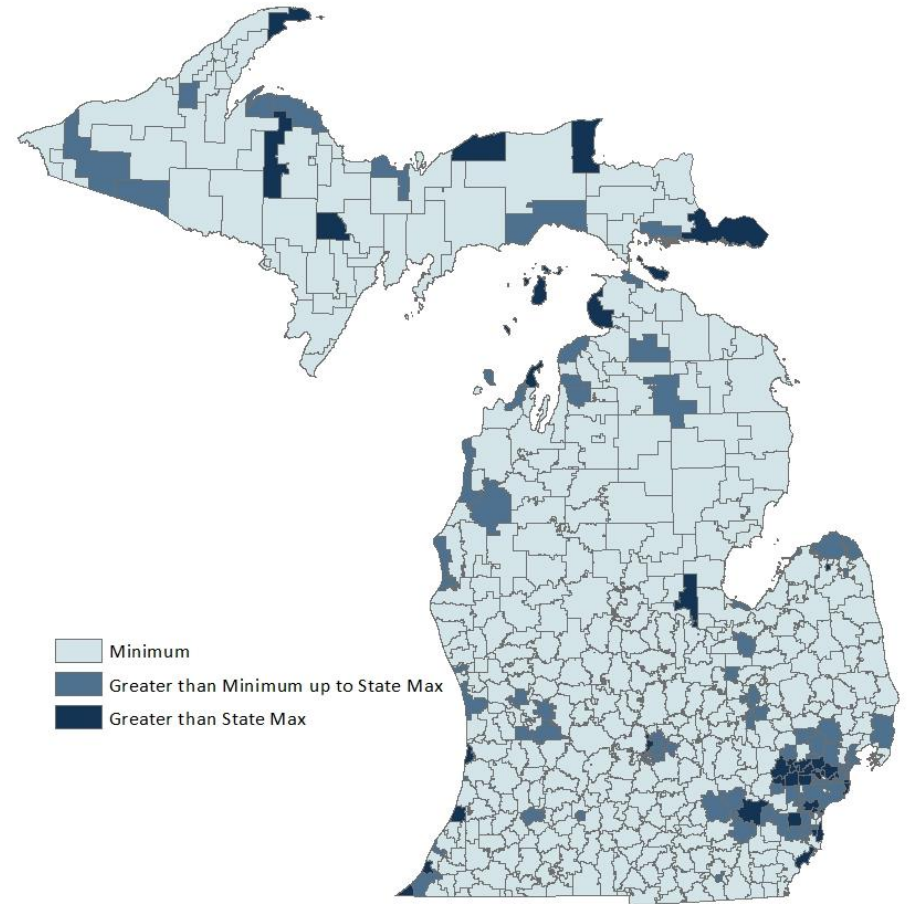


Figure 5: FY 2018-19 Per Pupil Foundation



Note: Maps do not include public school academies because they do not have a geographic boundary.

## DECLINING ENROLLMENT

After rising for nearly a decade following Proposal A, the statewide pupil membership peaked at nearly 1,715,000 in FY 2002-03 before declining to an estimated 1,480,000 in FY 2018-19, a drop of about 235,000 pupils. Under a per-pupil funding mechanism, fewer pupils means fewer dollars to districts, but also reduces state costs. In this case, the membership decline since FY 2002-03 equates to a loss of approximately \$1.9 billion for districts—based on the FY 2018-19 average foundation allowance. The losses related to declining enrollment have more than offset the overall funding increases achieved through foundation allowance increases over that same period. In FY 2002-03, total state and local foundation allowance funding equaled \$12.3 billion, and in FY 2018-19 it equals an estimated \$12.0 billion. [Table 3](#) below shows the pupil membership history.

**Table 3: Pupil Membership History**

Fiscal Year	Pupils	Change	% Change
1994-95	1,592,726		
1995-96	1,615,579	22,853	1.4%
1996-97	1,646,747	31,168	1.9%
1997-98	1,671,174	24,427	1.5%
1998-99	1,688,996	17,822	1.1%
1999-00	1,698,414	9,418	0.6%
2000-01	1,706,407	7,993	0.5%
2001-02	1,710,630	4,223	0.2%
2002-03	1,714,705	4,075	0.2%
2003-04	1,714,185	(520)	0.0%
2004-05	1,707,357	(6,828)	(0.4%)
2005-06	1,697,537	(9,820)	(0.6%)
2006-07	1,680,282	(17,255)	(1.0%)
2007-08	1,652,332	(27,950)	(1.7%)
2008-09	1,619,449	(32,883)	(2.0%)
2009-10	1,592,380	(27,069)	(1.7%)
2010-11	1,569,436	(22,944)	(1.4%)
2011-12	1,548,999	(20,437)	(1.3%)
2012-13	1,535,989	(13,010)	(0.8%)
2013-14	1,522,628	(13,361)	(0.9%)
2014-15	1,508,008	(14,620)	(1.0%)
2015-16	1,495,980	(12,028)	(0.8%)
2016-17	1,491,164	(4,816)	(0.3%)
2017-18	1,484,193	(6,971)	(0.5%)
2018-19	1,480,000	(4,193)	(0.3%)
<b>Total Change since FY 1994-95</b>		<b>(112,726)</b>	<b>(7.1%)</b>
<b>Total Change since FY 2002-03 peak</b>		<b>(234,705)</b>	<b>(13.7%)</b>