

MEMORANDUM



DATE: February 15, 2016
TO: All Interested Parties
FROM: Bethany Wicksall, Associate Director
RE: The Basics of the Foundation Allowance — FY 2015-16 Update

The changes in school funding in Michigan under Proposal A of 1994 brought about a new means of providing state funding to school districts. This new mechanism came in the form of the **foundation allowance**, whereby each school district is allocated a per pupil amount – in combined state and local funds – to support school operations. More than twenty years later we still use this school financing mechanism as the primary method of state support to school districts, but the methods for determining annual increases have varied from the original Proposal A model. This memo briefly discusses how the foundation allowance is determined and paid to schools and summarizes the methods used in recent years to allocate annual increases.

Initial Foundation Allowances

The foundation allowance was first used in Fiscal Year (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 allowances:

- the **Minimum** foundation allowance, set initially at \$4,200, to create a floor below which no district would fall.
- the **Basic** foundation allowance, which was a target or goal foundation allowance up to which the Proposal A drafters hoped to bring all districts over time, initially \$5,000.
- the **State Maximum** guaranteed foundation allowance, an amount over which the state would not contribute toward a district's per pupil revenue, which was set initially at \$6,500. (Certain districts, called "hold harmless" districts, have foundation allowances higher than the State Max using additional local revenue.)

Each of the three is discussed more fully below. [Appendix 1](#) provides a history of each of these levels and [Appendix 2](#) displays the growth of each over time.

The Basic Foundation Allowance

Since their original determination, district foundation allowances have been calculated each year by adding incremental dollar increases (or decreases) to the initial amount. The primary mechanism used to do this is the basic foundation allowance – or, simply "the Basic".

Originally set at \$5,000 per pupil in FY 1994-95, the Basic was essentially a target per-pupil funding level that the creators of Proposal A hoped all districts would reach one day. However, this standard was phased in over a period of several years. Rather than immediately bringing all districts up to the

Basic, the lowest-revenue districts were raised initially to a minimum foundation allowance, set at \$4,200 in FY 1994-95.

The Legislature and the Governor determined the increase in the Basic each year in the School Aid budget. They increased the minimum foundation allowance as well; districts with foundation allowances below the Basic received larger increases than districts with foundation allowances at or above the basic level. These larger increases were calculated with a formula – often referred to as the *2x formula* – that allocated for districts at the minimum foundation an increase equal to twice the amount of the increase in the Basic. Under the 2x formula, foundation allowances above the Basic are increased by the same amount as the increase in the Basic, and foundation allowances between the minimum foundation and the Basic are increased incrementally on a sliding scale calculated by the formula.

This funding mechanism lessened the inequities in per pupil funding among school districts. Using the 2x formula, the minimum foundation allowance was raised to the Basic level of \$5,700 in FY 1999-2000. With that, all districts reached the Basic for the first time, and Proposal A's goal to raise all districts' per pupil funding to at least the level of the Basic was achieved.

Annual 2x Formula Increases

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

Once all districts had reached the Basic, from FY 2000-01 to FY 2006-07, all school districts received the same dollar increase in their foundation allowance as the annual increase in the Basic (except in cases of equity payments to increase the minimum foundations). 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, resetting the Basic to the State Max, thus creating a new goal. However, after using the 2x formula again for two years, beginning in 2010, foundation allowances were reduced for three consecutive years. And, in more recent years, the Legislature has used a mix of across-the-board increases, equity payments to districts at the Minimum foundation, and 2x formula increases, which are discussed in more detail under **Recent History** below.

State Maximum Guaranteed Foundation Allowance

The highest amount that may be used when calculating the state portion of the foundation allowance is the state maximum guaranteed (State Max) foundation allowance. When the Proposal A reforms were first created, the State Max was set at \$1,500 above the Basic, and it remained at that level each year until FY 2001-02, when a \$200 equity payment increased the Minimum, thereby decreasing the gap to \$1,300. Another equity payment of \$23 per pupil was provided in FY 2006-07 and rolled into district foundation allowances the following year. At that point, the gap decreased to \$1,277.

In FY 2007-08, when the Legislature increased the Basic to the State Max, and returned to the original 2x formula, moving all district up to the State Max became the new long-term goal. Through recent use of the 2x formula and further equity payments, the equity gap has decreased to \$778 for FY 2015-16.

In addition, the State Max is also used to determine so-called "hold harmless" districts. These are districts with a foundation allowance above the State Max and, as such, are allowed to levy additional

local hold harmless millages to make up the difference between the State Max (now adjusted downward for their former Sec. 20j allocations¹) and their foundation allowances. There are 44 such districts in the state, which can be divided into three groups:

- 24 districts that actually levy an additional hold harmless millage.
- 14 "out-of-formula" districts that generate enough revenue from their local general operating non-homestead millages to exceed their statutory foundation and so do not need to levy additional hold harmless millages.
- 6 districts that do not levy their allowable hold harmless millages and receive just the State Max even though their statutory foundation allowances exceed it.

Recent History

In FYs 2009-10 and 2010-11, while district foundation allowances technically remained unchanged, districts were subject to a per pupil reduction of \$154 in FY 2009-10 and a \$170 per pupil reduction in FY 2010-11 under a separate section of the School Aid Act (MCL 388.1611d). Additionally for three years between FY 2008-09 and FY 2010-11 during and after the Great Recession, the state portion of foundation allowances were subsidized with Federal stimulus funds ranging from approximately \$283 per pupil to \$380 per pupil.

In FY 2011-12, while School Aid Fund revenues had rebounded sufficiently to backfill both the end of federal stimulus funds along with the Sec. 11d per pupil reduction, both tax and budget policy changes significantly reduced the School Aid Fund revenues in the School Aid budget. The \$170 per pupil reduction was rolled into an actual, ongoing foundation allowance reduction, along with a further reduction of \$300 per pupil. In all, FY 2011-12 foundation allowances for all districts were cut by \$470. The minimum foundation allowance dropped to \$6,846, lower than it had been in FY 2005-06.

Since then, the method used for increases in the following four budget years has varied significantly each year, but each has focused on further diminishing the funding gap between the Minimum and the State Max:

- In FY 2012-13, the School Aid budget included the first foundation allowance increase since FY 2008-09; however, only districts at or near the Minimum received an increase – through an equity payment which raised the Minimum by \$120 per pupil to \$6,966.
- In FY 2013-14, the School Aid budget included both an increase for all districts through the 2x formula, ranging from \$30 to \$60 per pupil, as well as an equity payment of up to \$50 per pupil for districts at or near the new Minimum, bringing it up to \$7,076 (including the equity payment).
- In FY 2014-15, an across-the-board increase of \$50 per pupil was provided to all school districts with an additional equity payment of up to \$125 per pupil to districts at or near the Minimum, bringing it up to \$7,251 (including the equity payment).

For FY 2015-16, the School Aid budget includes a 2x formula increase ranging from \$70 to \$140 per pupil. The Minimum is \$7,391 and the State Max is \$8,169. The Minimum for FY 2015-16 is now higher than its previous high of \$7,316 in FY 2008-09. The State Max at \$8,169 is still slightly lower than it was a decade ago in FY 2005-06 and is \$320 lower than its previous peak in FY 2008-09. The gap between the Minimum and the State Max has been reduced to \$778 per pupil.

District and Pupil Distribution

Over time, as the 2x formula and equity payments diminished the gap between the Minimum and the State Max by bringing districts at the bottom up, an increasing number of districts and a higher concentration of pupils have landed at the Minimum. In FY 2015-16, 705 out of 841 traditional and

¹ For more information regarding Sec. 20j, please see the House Fiscal Agency memo from February, 2016 "Section 20j History and FY 2016-17 Executive Recommendation".

charter districts, or 83%, are at the Minimum. With 44 hold harmless districts above the State Max, 92 districts fall somewhere in between the two. Approximately 62% of the total student population are enrolled in districts with a foundation allowance at the Minimum, while about 12% are enrolled in hold harmless districts, and 26% of the student population are in between the two.

As a result of the Minimum picking up a growing share of districts and pupils over time, further efforts to diminish the gap between the Minimum and State Max, by bringing the bottom up, cost more each time as the larger increases apply to more pupils.

The State-Local Funding Split for the Foundation Allowance

The total amount of revenue a district receives for its foundation allowance is derived by multiplying the number of pupils the district educates by its foundation allowance. For example, if a district with a foundation allowance of \$7,500 has 1,000 pupils, it would receive \$7.5 million in foundation allowance revenue (\$7,500 × 1,000). However, the state pays only a portion of this revenue: the amount remaining after subtracting from the total foundation allowance revenue the amount of local revenue that the district collects from non-homestead property taxes.

Under Proposal A, school districts levy 18 mills (or the number of mills levied in 1993, whichever is less) on non-homestead property. For the purposes of determining the state portion of the foundation allowance, it is assumed that districts levy the full 18 mills on non-homestead property.

Generally, the state portion of the foundation allowance equals:

$$\left(\text{Membership Pupils} \times \begin{matrix} \text{Lesser of} \\ \text{a district's foundation} \\ \text{allowance} \\ \text{Or} \\ \text{the State Max (\$8,169)} \\ \text{Adjusted for former Sec. 20j} \\ \text{payments} \end{matrix} \right) - \text{Assumed local non-homestead property tax revenue}$$

Using our previous example, a district with a \$7,500 foundation allowance and 1,000 pupils would receive a total of \$7.5 million in foundation allowance revenue. However, if the district raises \$4.5 million in local revenue from its 18-mill non-homestead tax, the state pays only \$3.0 million of the \$7.5 million. In this example, the state pays \$3,000 per pupil (\$3.0 million ÷ 1,000 pupils) toward the district's \$7,500 foundation allowance and the local district pays \$4,500 per pupil. This state/local mix is different for every district and changes for each district from year to year depending on the local non-homestead taxable value growth and number of pupils. There are 35 “out-of-formula” districts (14 of which are also hold harmless districts) that generate enough revenue from their local general operating non-homestead millages to exceed their statutory foundation, and as such do not receive any state funds toward their foundation allowances.

Public School Academy (PSA) Foundation Allowances

Prior to FY 2007-08, the foundation allowance for a PSA was the *lesser* of the following:

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

This meant that in FY 2006-07, PSAs received a maximum of \$7,385, which was \$300 above the \$7,085 Basic that year.

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 the highest PSA foundation allowance was when the formula was restored. The PSA Max was \$7,580 from FY 2008-09 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 over the last few years, in FY 2014-15 the Minimum grew past the PSA Max, making them equal. So all PSA foundations are now at the Minimum, \$7,391. PSAs do not levy local property taxes, and therefore the state funds 100% of their foundation allowances.

Pupil Membership Blend

Pupil "membership," is the number of pupils used when calculating the amount of foundation allowance revenue a district will receive. Until FY 2013-14 it had been calculated by adding a percentage of the number of full-time equivalent (FTE) pupils counted in October of the current school year to a percentage of those counted during the *prior* February. The pupil membership blend initially began with 50% of the Fall count and 50% of the *prior* February count, but has varied significantly over time, typically weighting the Fall count more heavily. (See [Appendix 3](#) for a history of the pupil membership blend.)

However, for FY 2013-14 and FY 2014-15, for the first time since Proposal A, the pupil membership blend was equal to 90% of the October count plus 10% of the *following* February pupil count. While this meant 100% of a district's funding was based on current year students, districts did not know their final pupil membership blend (or final related funding) until near the end of the school year. Under this type of blend, districts also experienced the full fiscal impact of declining enrollment more quickly without the membership blend including any portion of the prior year count.

For FY 2015-16, the pupil membership blend has been revised again to revert to the same blend used in FY 2011-12 and FY 2012-13, which is 90% of the October count plus 10% of the *prior* February pupil count, or a 90/10 blend.

Declining Enrollment

Statewide, there were approximately 1,508,000 million membership pupils in FY 2014-15 and 1,496,000 in FY 2015-16, and we estimate that pupil memberships will decline to approximately to 1,486,000 in FY 2016-17. As the number of pupils decreases, the cost for the state portion of foundation allowances goes down. However, with all general operating revenues based on pupils, districts face reduced revenue, and while they have fewer pupils related expenditures typically don't decrease as quickly. In FY 2015-16, 485 (out of 841) districts had fewer pupils than they did in the prior year.

**Appendix 1: The Minimum, Basic, and State Maximum Foundation Allowances
FY 1994-95 to FY 2015-16**

Fiscal Year	Minimum Foundation Allowance	Basic Foundation Allowance	State Maximum Foundation Allowance	Minimum Increase/ (Decrease)	Basic & State Max Increase/ (Decrease)	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 ¹	\$6,500	\$6,500	\$7,800	\$500	\$300	\$1,300
2002-03	\$6,700	\$6,700	\$8,000	\$400	\$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 ²	\$7,108	\$7,108	\$8,385	\$233	\$210	\$1,277
2007-08 ³	\$7,204	\$8,433	\$8,433	\$96	\$48	\$1,229
2008-09	\$7,316	\$8,489	\$8,489	\$112	\$56	\$1,173
2009-10 ⁴	\$7,316	\$8,489	\$8,489	\$0	\$0	\$1,173
2010-11 ⁵	\$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 ⁶	\$7,076	\$8,049	\$8,049	\$110	\$30	\$973
2014-15 ⁷	\$7,251	\$8,099	\$8,099	\$175	\$50	\$848
2015-16	\$7,391	\$8,169	\$8,169	\$140	\$70	\$778

¹ The minimum foundation includes an equity payment of \$200, which was officially rolled into foundations in FY 2002-03.

² 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.

³ 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.

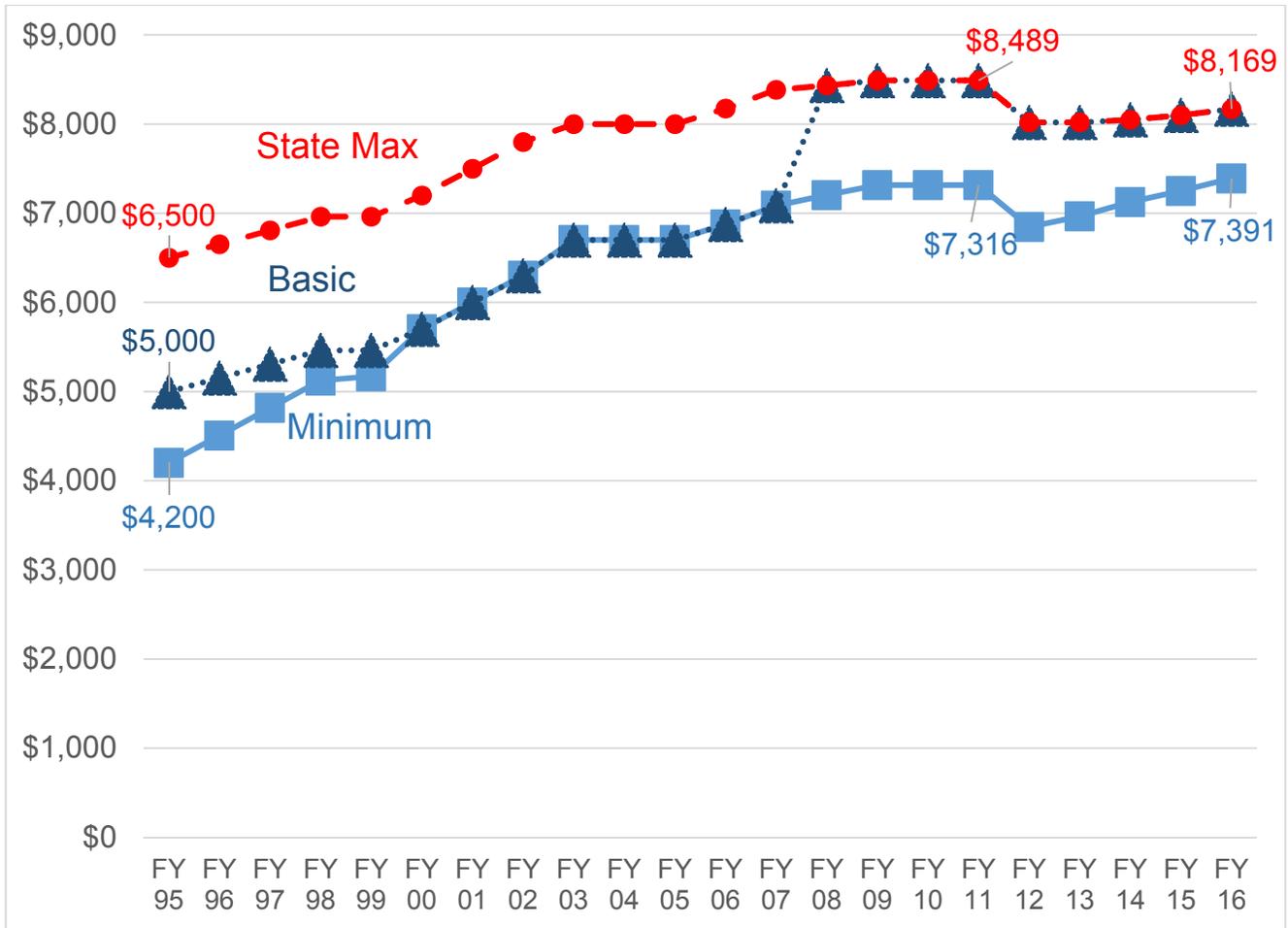
⁴ While the foundation allowance was not changed, the budget included a \$154 per pupil reduction under Section 11d.

⁵ While the foundation allowance was not changed, the budget included a \$170 per pupil reduction under Section 11d.

⁶ The minimum foundation included an equity payment of \$50, which was officially rolled into foundations in FY 2014-15.

⁷ The minimum foundation includes an equity payment of \$125, which was officially rolled into foundations in FY 2015-16.

**Appendix 2: The Minimum, Basic, and State Maximum Foundation Allowances
FY 1994-95 to FY 2015-16**



**Appendix 3: Pupil Membership Blend Changes
FY 1994-95 to FY 2015-16**

Fiscal Year	Fall Count	Prior February Count	Following February Count
1994-95	50%	50%	
1995-96	50%	50%	
1996-97	50%	50%	
1997-98	60%	40%	
1998-99	60%	40%	
1999-00	75%	25%	
2000-01	80%	20%	
2001-02	80%	20%	
2002-03	80%	20%	
2003-04	80%	20%	
2004-05	75%	25%	
2005-06	75%	25%	
2006-07	75%	25%	
2007-08	75%	25%	
2008-09	75%	25%	
2009-10	75%	25%	
2010-11	75%	25%	
2011-12	90%	10%	
2012-13	90%	10%	
2013-14	90%		10%
2014-15	90%		10%
2015-16	90%	10%	