

DATE: September 6, 2013
TO: All Interested Parties
FROM: Bethany Wicksall, Associate Director
RE: The Basics of the Foundation Allowance — FY 2013-14 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. This memo briefly discusses how the foundation allowance is determined and paid to schools.

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 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 that no district would fall below.
- 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** 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 have foundation allowances higher than the state maximum with 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 shows 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" level, the lowest-revenue districts initially were raised 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.

But, in FY 2007-08, the Legislature reestablished the use of the 2x formula, resetting the Basic to the State Maximum Foundation Allowance level, thus creating a new goal. However, after using the 2x formula for two years, since 2010 districts have experienced mainly frozen or reduced foundation allowances.

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). In FY 2011-12 the \$170 per pupil reduction was rolled into the foundation allowance, along with a further reduction of \$300 per pupil. In all, FY 2011-12 foundation allowances for all districts were cut by \$470.

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 foundation allowance by \$120 per pupil to \$6,966. In FY 2013-14, the School Aid budget includes 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.

In FY 2013-14, the effective minimum foundation allowance (including the equity payment) of \$7,076 is lower than it was in FY 2006-07. The State maximum foundation allowance at \$8,049 is just \$49 higher than it was over a decade ago in FY 2002-03.

State Maximum Foundation Allowance

The highest amount that may be used when calculating the state portion of the foundation allowance is the "state maximum" foundation allowance. When the Proposal A reforms were first created, the state maximum foundation allowance 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 foundation, 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 maximum, and returned to the original 2x formula, the state maximum became the new goal. The equity gap was essentially revised to mean the difference between the state maximum and the minimum foundations. Through recent use of the 2x formula and further equity payments, the equity gap has decreased to \$973 for FY 2013-14.

In addition, the state maximum foundation allowance is also used to determine so-called "hold harmless" districts. These are districts with a foundation allowance above the state maximum and, as such, are allowed to levy additional local hold harmless millages to make up the difference between the \$8,049 state maximum 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.
- 13 "out-of-formula" districts that generate enough revenue from their local general operating nonhomestead millages to exceed their statutory foundation and so do not need to levy additional hold harmless millages.
- 7 districts that do not levy the hold harmless millages and receive just the state maximum foundation allowance even though their statutory foundation allowances exceed it.

District and Pupil Distribution

Over time, as the 2x formula moved toward equity by bringing districts at the bottom up, an increasing number of districts and a higher concentration of pupils have landed at the minimum foundation allowance. In FY 2012-13, over half (451 out of 826 traditional and charter districts) were at the minimum foundation. With 44 hold harmless districts at or above the state maximum, 331 districts fall somewhere in between the two. Approximately 46 percent of the total student population were enrolled in districts with a foundation allowance at the minimum, while about 12 percent were enrolled in hold harmless districts, and 42 percent of the student population were in between the two.

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 ($\$7,500 \times 1,000$). However, the state pays only a portion of this revenue, paying 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 are required to 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:

$$\left(\text{Membership Pupils} \times \begin{array}{l} \text{Lesser of} \\ \text{a district's foundation allowance} \\ \text{Or the state maximum (\$8,019)} \end{array} \right) - \text{Assumed local non-homestead property tax revenue}$$

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 and number of pupils.

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 public school academy is located or
- \$300 above the Basic.

This meant that in FY 2006-07, public school academies 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 is the lesser of

- the foundation allowance of the local district in which the public school academy 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. For FY 2013-14 it will increase to \$7,168. Public School Academies do not levy local property taxes, and therefore make no local contribution to their foundation allowance.

Pupil Membership

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 has 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 over time. In FY 2011-12 and FY 2012-13, the membership blend was 90% of the October count plus 10% of the *prior* February pupil count, or a 90/10 blend.

However, for FY 2013-14, for the first time since Proposal A, the pupil membership blend will be equal to 90% of the October count plus 10% of the *following* February pupil count. This means all of the funding for a district will be based on current year students, and districts will not know what their final pupil membership blend is until near the end of the school year. Districts also experience the full fiscal impact of declining enrollment more quickly without blending any of the prior year count.

Statewide, there were approximately 1.54 million membership pupils in FY 2012-13, and we estimate that pupil memberships will decline to approximately 1.53 million in FY 2013-14.

**Appendix 1: The Minimum, Basic, and State Maximum Foundation Allowances
FY 1994-95 to FY 2013-14**

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

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 includes an equity payment of \$50, which may be officially rolled into foundations in FY 2014-15.

Appendix 2: Foundation Allowance History Growth Since Proposal A

