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December 15, 2014

M E M O R A N D U M

TO: State Board of Education

FROM: John C. Austin, President, State Board of Education

SUBJECT: Discussion on Michigan School Organization and Finance

The State Board of Education will discuss the attached document, Recommendations for Change to Michigan School Organization and Finance, at its meeting on December 16, 2014.

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Michigan State Board of Education
Recommendations for Change to
Michigan School Organization and Finance

Pursuant to our Constitutional mandate to provide policy leadership and recommendations to the Governor and Legislature regarding the financial requirements of Michigan education, in January of 2014 the State Board began a process to drive understanding of Michigan School Finance and Organization issues and needs, identify priorities, and make recommendations for change.

Over the intervening months the State Board of Education has heard detailed analyses of the issues and recommendations for change from the public, dozens of stakeholders, researchers and education policy analysts from across the spectrum. These analyses offered a variety of perspectives about challenges and problems with Michigan's current education finance model, as well as provided insights into potential solutions, including the approaches used by successful state systems elsewhere.

To inform ourselves and the public discussion of these important issues, we bring forward a summary of the major issues that demand attention, if we are to improve educational achievement in Michigan. This context is followed by recommendations for actions and changes in school finance and policy that attend to these challenges.

The Context Demanding Change

Improving Michigan's Flagging Educational Performance

Twenty years after Proposal A fundamentally altered Michigan's school finance policy, our system of organizing and financing education in Michigan is once again in need of fundamental change. The most important spur for action is the fact that once an education leader, Michigan is now in the bottom tier of states in academic achievement, and other states are racing past us in improving student performance.

While Michigan's total K-12 funding of $12,644 per pupil is the 22nd highest in the US, (8th if adjusted for per capita income), our rank on the *Nation's Report Card* NAEP math and English scores hover around 38th. Michigan now ranks in the bottom five states for learning progress in fourth grade reading and math over the last decade; and has seen all groups of students, white, African-American, Latino, low and high income – fall in the comparative ranks of student achievement.[1]

[1] Education Trust Midwest: *Stalled to Soaring*, April 3, 2014

Education Funding Trends

The debate about the level of investment in Michigan public education, and the appropriate level of investment to support learning, is contentious. Some states that spend relatively more are doing better, like Massachusetts; while it is also true that some states that spend less are seeing faster learning gains, like Florida. Many districts with relatively high levels of funding, struggle academically, while there are "Beating the Odds" schools that receive Michigan's lowest foundation grant, but are using it to rapidly increase student achievement. Some facts about Michigan's funding dynamics:

- In real inflation-adjusted dollars Michigan's spending on K-12 education has declined 16% from 2004 to 2014.[2]
- The overall "level of effort" – state and local revenues spent on K-12 education as a percentage of Michigan's personal income – has dropped from 4.1% to 3.4% over the past ten years[3].
- State funding is up in nominal dollars $1 billion from four years ago, but, in the words of the respected non-partisan Citizens Research Council (CRC): "the increase is almost exclusively earmarked to satisfy school employee retirement costs", and, "MPSERS costs, on the aggregate, have grown significantly over the five year period, and the share of the foundation allowance available for other typical classroom expenses has increased very modestly, but has not kept up with general inflation."[4]

Declining Enrollments Interacting with Choice Policy, Charter/Cyber School Expansion Policy

With funding flowing largely through the per pupil foundation grant, the financial condition of schools and performance of Michigan's school children is affected directly by enrollment changes.

- Michigan has seen overall declining enrollments from a high of 1,714,867 students in 2003, to a current 1,523,300, a decline of 11% over ten years.[5]
- This has been coupled with an increase in the numbers of schools. Michigan has gone from 560 to nearly 800 school districts over the past 20 years.[6]

Statewide declining enrollments combined with choice and charter policy have seen significant swings in enrollment, and hence the financing available for particular schools. For most this movement has been down.

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[2] Center for Michigan, *Community Conversations Issue Guide*, April 2014, citing "Changes in State Appropriations" Memo, House Fiscal Agency, 2013, (http://www.house.michigan.gov/hfa/)

[3] Michigan School Organization and Finance, Presentation to the State Board of Education, Phil Kearney and Mike Addonizio, February 11, 2014

[4] CRC Memorandum: *Making Sense of K-12 Funding*, October 2014. (Public School Academies, or charter schools are their own school districts, which explains most of the increase).

[5] Citizen Research Council presentation to State Board of Education, Michigan School Organization and Finance, March 11, 2014

[6] Citizen Research Council presentation to State Board of Education, Michigan School Organization and Finance, March 11, 2014

- According to the CRC, 420 of Michigan's charters and traditional public school districts have seen declining enrollments over the last ten years, versus 125 with increases.
- Over the most recent five years, 70% of all districts saw some amount of enrollment decline and over one-quarter of all districts had declines of 10% or more[7].

According to the CRC, these trends have contributed to an increase in student-teacher ratios in two–thirds of districts[8], and in the extreme cases, contributed to the declining quality and enrollment 'death spiral' that has brought over 50 school districts into deficit. The decline in statewide pupil enrollment has also been the second biggest factor driving the increase of employer contribution rates for unfunded accrued liabilities.[9]

Given these trends, what is the overall fiscal condition of most schools today? Again, here's the CRC's assessment:

> *"While the amount of per-pupil funding is up, districts are paying higher retirement bills. This leaves fewer resources for other school expenses. Also, total funding at the district level is greatly influenced by the number of students enrolled. Because declining enrollment is a pervasive issue across the state, the vast majority of traditional public school districts must manage the fiscal effects of having less non-retirement funding to operate."*[10]

Need to Spend "Smarter"

Michigan's poor performance is not fully explained by the overall investment or dollars available for public education in particular public schools – whether charter or traditional – but how that money is spent. States that are improving in educational performance are doing so by more strategically investing in high yield approaches that support improved outcomes, including teacher quality improvements, extra support for poor and at-risk students[11], structured school turnaround efforts, and enhanced early childhood education[12], where Michigan *has* made headway.

Michigan has made many of the same significant reforms as higher performing and faster improving states: from more rigorous learning standards, to new teacher quality and evaluation expectations, to demanding accountability provisions. What Michigan *has not done* that other more successful states have done, is combine these reforms with the investment and capacity-building necessary to implement them effectively.[13]

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[7] CRC Memorandum: *Making Sense of K-12 Funding*, October 2014

[8] Citizen Research Council presentation to State Board of Education, Michigan School Organization and Finance, March 11, 2014

[9] House Fiscal Agency, Analysis of SB 620, 9/18/12.

[10] CRC Memorandum: Making Sense of K-12 Funding, October 2014 p.7

[11] In "Equity is the Key to Better School Funding", Education Week, March 28,, 2014, a Boston Consulting Group study finds: "By far the most statistically robust finding in our analysis was the role of increased funding equity in student outcomes. Equity should require that every student receives sufficient resources to have the same chance to succeed, rather than that every child gets the same level of funding."

[12] *Stalled to Soaring, Michigan's Path to Educational Recovery*, The Education Trust Midwest, 2014

[13] Bridge Magazine, Smartest Kids: *What Michigan Schools Can Learn from Leading States*, October 14, 2014

Holes and Flaws in Proposal A and New Problems with Michigan School Finance System

Finally, the State Board's year-long examination of challenges to our Michigan education system also revealed a number of other significant features driving both financial and performance challenges in our schools:

- Holes and flaws in Proposal A that provide no state support for school buildings and technology[14]; and have led to differential tax treatment of similar local properties that affect revenues available for education.
- A strategy built into Proposal A – the regional 3 mill levy opportunity – envisioned to support local communities who chose to invest more in their schools, that has not worked in practice.
- Funding and pupil accounting system that serves to discourage, not encourage, participation in dual enrollment and early college programs that are very effective at improving learning outcomes for both at-risk and high-achieving students.[15]
- Mushrooming costs of the retirement system: Proposal A shifted full responsibility for funding MPSERS to school districts. A combination of factors, from declining enrollments, fewer employees in the system, and the market financial collapse have meant the total unfunded accrued liability for MPSERS increased from $12 billion in 2009 to $25 billion. To cope with this reality total MPSERS specific funding, including new state funding, has increased five-fold from $155 million in 2012 to $883 million today[16].
- Significant and growing disparities in special education funding and services between districts. The per pupil spending for special education students are now $14,397, versus $9,633 for all K-12 students, and the cost difference has grown significantly since Proposal A[17]; and spending differences between ISDs are now great.

[14] Michigan School Organization and Finance, Presentation to the State Board of Education, Phil Kearney and Mike Addonizio, February 11, 2014

[15] Community College Research Center; What We Know About Dual Enrollment, 2012, and Early College Continued Success, Early College Impact Study, AIR, 2014

[16] CRC Memorandum: Making Sense of K-12 Funding, October 2014

[17] Citizen Research Council presentation to State Board of Education, Michigan School Organization and Finance, March 11, 2014

Recommendations for Change

While renewing our efforts to provide the consistent support and level of effort for public education envisioned by the architects of Proposal A, Michigan must also change the way we spend money, combining strategic investment with reforms that ensure the investment supports learning gains. We must change an inchoate school choice and charter policy to an approach that works to improve learning and outcomes for all students, and buffers the financial shocks from enrollment changes. Michigan also must fix important flaws that have always existed in Proposal A – from the lack of state support for school infrastructure and technology; to the inability of local schools to raise additional local resources for public education. Finally Michigan needs new treatment of emerging special education and retirement costs; that impact resources and performance in Michigan classrooms.

The State Board of Education asks the next Administration and Legislature to work with us to make school organization and finance change a priority, and modify our system in the following directions that can help Michigan retake leadership in learning, and improve student outcomes.

Priorities for education finance and organization system reform include:

Consistent Level of Effort for Education

Ensure predictable funding for K-12 education that maintains a consistent level of state effort and budget priority. The architects of Proposal A, on a bi-partisan basis, hoped that it would create a funding system that was both more equitable, but also durable in providing a consistent flow of resources to public education, in good times and bad. Since that time Michigan has been through hard economic times, made changes in tax and budget policy, as well as use the School Aid Fund to support other priorities – all of which have affected the bottom line for K-12 education. There is no right magic number for school funding, but the strong bi-partisan support for healthy education investment and a predictable flow of resources suggests support for this funding priority is strong.

We recommend, as comprehensive school finance reform is considered and to maintain education as a budget priority, the Governor and Legislature publically set a target for the annual "level of effort" in terms of state investment, and stick with it. This could be a target for spending as a share of the state's per capita income, or total tax revenues.

We also recommend the state should return to the policy of protecting the school aid trust fund from being used to fund other priorities.

Spend Smarter

Michigan needs to make a deeper investment in K-12 education, but not to fund the status quo. Michigan can strategically invest dollars it does spend on strategies demonstrated to improve learning performance.

Differential Funding

Michigan should follow the example of high-performing states and move away from a one-size fits all foundation grant and develop a new funding formula – that provides differential funding based on costs and educational returns from different types of instruction and schools, and the differential needs of students. Michigan does have law providing categorical support for at-risk students at 11.5% of the foundation grant; however the actual money appropriated has remained fixed since 2009, and not keeping up with growing at-risk student numbers, meaning actual per pupil at-risk funding equals 7% of the foundation grant.

Important features of a differential funding system should include:

- Enhanced differential funding for at-risk, economically disadvantaged students;
- Differences in cost based on geography (urban, rural), transportation costs, cost of living, and other variables.
- Differences in the costs of various learning programs, and levels of education, e.g., high schools, middle schools, and elementary schools; and differences in cost in providing full-service schools vs. online education.
- A differentiated funding system could also pay more for more robust learning programs that arguably deliver more in terms of outcomes by blending and accelerating secondary and postsecondary learning. Early colleges, middle colleges, IB, dual and concurrent enrollment programs, many CTE and STEM programs; all support high school students in earning post-secondary credits and credentials. These programs are very effective at increasing postsecondary credential attainment rates for both at-risk and high achieving students. Differentiated funding that provided more per-pupil resources for these programs, would also deliver the needed financial incentive for high schools and post-secondary institutions to encourage and facilitate more students participating in these programs.

As was successfully done in Massachusetts, a short-term expert and education stakeholder commission could be charged to design a new differential funding formula based on research, and experience with costs, strategies and learning models, and their impact on student learning and outcomes.

Invest in Proven Strategies for School Improvement

Michigan has made many reforms, but has not coupled these reforms with research-based instruction and organizational improvements. Michigan should include in a revised funding formula enhanced resources to support student learning growth and success that are accompanied by clear performance expectations and strong accountability. One such strategy would be a discretionary grant program for districts needing improvement who implement one of a number of strategies determined by the MDE proven to improve instruction, school climate/culture, and academic outcomes (such as such as Michigan Teacher Core, and Multi-tiered systems of support (MTSS) that incorporates high leverage and personalized instruction). Such a program should include independent evaluation of their success to support improvement and replication.

Invest in Teachers and Early Childhood

The effectiveness of the classroom teacher, and quality early childhood education are the strongest drivers of learning gains, particularly for poor and at-risk students. Leading states like Minnesota provide high quality preschool education to all, at a sliding fee scale based on incomes. Central to Massachusetts march to first-place in education outcomes, was investment in the development and retention of talented educators, and support for collaborative professional development focused on local needs, like closing persistent achievement gaps, and using data to improve performance.[18] Michigan must continue to expand quality early childhood education, and make a budget priority of teacher/educator preparation, support, and professional growth as powerful levers to increase student achievement.

Couple Reforms with Capacity-Building

Ensure significant education reforms and new demands (e.g., new standards, new teacher training and evaluation) are accompanied by sufficient resources to build capacity of schools and educators to adapt and effectively implement reforms. Florida has invested heavily in teacher training in support of early reading reforms. Tennessee has invested to train 70,000 teachers to implement the Common Core. Michigan must combine current reforms (new standards, teacher evaluations), and future reforms with requisite investment in their implementation to support success. Michigan should also invest in capacity and technical assistance to district administration and principals on how they can use all funding streams (including those outside traditional school finance, e.g. Health and Human Services), as well as the existing flexibility in state and federal funding, to achieve better outcomes.

[18] Readiness Centers Initiative. http://www.mass.gov/edu/government/special-initiatives/education-for-the-21st-century/commonwealth-readiness-project/readiness-goal-2-educators-and-leaders/readiness-centers/readiness-centers-initiative.html

Reform Choice and Charter Policy

Michigan's open-ended approach to charter and cyber schools and expansive choice policy, unfolding in an environment of overall declining enrollments, have had negative repercussions on almost all schools. More than 70 charter schools have opened since 2011, and additional cyber schools.[19] Michigan should develop a reformed approach to school finance, school choice, and charter policy that accomplishes several things:

- Create a community driven "certificate of need" process, particularly in major urban school markets where charters and choice-making are most prevalent, and schools may open and close in a non-strategic manner. Such a process should attend to issues of neighborhood and community needs, provide greater transparency in school site decision making, and ensure equal access and opportunity to attend a quality school, by accommodating transportation needs (as in major metropolitan communities in other states with similar school choice and charter dynamics).

- Soften the financial impact of changes in enrollment patterns driven by choice-making. This could be accomplished by gradual, not total reduction in foundation grant funding when new choices are made; or changes in foundation grant allotment for choosing "home" versus neighboring schools.

- Make changes to Michigan school law ensuring equal transparency, clear accountability, and quality control for all schools as well as any Education Management Company that operates under a sweep contract, as previously recommended by the State Board of Education[1].[20].

Fix "Flaws" in Proposal A and Emerging Financial Issues

A state mechanism to support financing of vital school capital, infrastructure and technology that supports all schools and districts. Michigan is one of only 12 states that provide no aid to local districts for capital projects; and the greatest needs are in property poor districts that continue to lose students to schools of choice.[21] Reform strategies could include a state equalization of local district capital outlays[22]; or a proposal offered by Proposal A architect Doug Roberts and David Olmstead, to dedicate an additional 10% to the foundation grant for capital expenses.

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[19] Ed Trust-Midwest conducted an analysis of charter school expansion using data from the Michigan Educational Entity Master. http://www.cepi.state.mi.us/eem/PublicDatasets.aspx
[20] Reference State Board Action on Charter Policy – August 2014
[21] Addonizio, Kearney, Presentation to State Board of Education, February 11, 2014
[22] Addonizio, Kearney, Presentation to State Board of Education, February 11, 2014

Create a functional mechanism to allow local districts to effectively raise additional local revenues without recreating significant inequities between districts. Proposal A architects thought they had created an option for raising additional local revenues for education; the current law that allows enhancement millages at the ISD level, but not at the district level. This ISD regional enhancement option has only been used three times since the adoption of Proposal A and has proven politically ineffective as a means for raising local resources for education enhancement.

Strategies to consider include reinstatement of local district enhancement millage, a district being allowed to vote an additional operational millage on local property for a specified number of years, that will be equalized by the state at 80 percent.[23]; or allow local school districts to pass an enhancement millage with the constraint that no school would receive net revenue per student exceeding the amount consistent with average property wealth in the intermediate school district (ISD); "excess" resources raised by high property value districts would augment funding for low-property wealth districts who also passed an enhancement millage[24].

Policy that attends to significant and growing disparities in special education funding and services between districts. Policy response needs to include a centralization of additional state-raised resources and reduced reliance on local property taxes to "lift the bottom" and better equalize ratios.

Revise tax provisions around "new" and "existing" property to create comparable values and revenues for education. After Proposal A, property tax growth was limited to the lesser of 5% or the rate of inflation each year. Property tax rates adjust to 50% of the value of a home upon its sale, creating inequities among taxpayers, and a large tax increase or "pop-up" tax for homeowners who move. The Headlee Amendment requires that property tax rates be "rolled back" when the growth in assessed value exceeds inflation. Combined, these restrictions limit the growth in property tax revenues dedicated to schools. Reforms could revise these provisions around the tax treatment and timing of treatment for comparable properties.

Additional steps to solidify pension system and stabilize its costs. MPSERS employer required contribution rate has increased from 13% in FY2004 to 24.46% in FY2012. According to the House Fiscal Agency state contributions to MPSERS may consume all of the projected growth in the school aid fund for several years. Steps to manage this crisis could include all certified new teachers enroll in MPSERS pension system, and shift unfunded accrued liability (UAL) costs from school payrolls to employers current operating expenditures (COE) which can keep the retirement costs with the employer who incurred them.

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[23] Addonizio, Kearney, Presentation to State Board of Education, February 11, 2014

[24] Glenn Oxender, Refinement Plan for Enhancement Millage, Ann Arbor Schools; other educators have similar proposals.