Independent Fiscal Office

An Analysis of Michigan Property Tax Reform

September 16, 2013

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About the Independent Fiscal Office

The Independent Fiscal Office (IFO) provides revenue projections for use in the state budget process along with impartial and timely analysis of fiscal, economic and budgetary issues to assist Commonwealth residents and the General Assembly in their evaluation of policy decisions. In that capacity, the IFO will not support or oppose any policies it analyzes, and will disclose all methodologies, data sources and assumptions used in published reports and estimates.

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INDEPENDENT FISCAL OFFICE

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September 16, 2013

To: The Honorable Kerry Benninghoff and The Honorable Phyllis Mundy:

This report presents the results from an analysis of the Michigan property tax reform known as Proposal A. Enacted in 1994, Proposal A replaced all local property taxes used for school operating purposes with higher sales and use, realty transfer and tobacco taxes. It also created a distinction between homestead and nonhomestead property to facilitate the statewide levy of uniform property taxes on those classes of property. The report makes extensive use of data published by various Michigan executive and legislative agencies to illustrate the impact of property tax reform on tax revenues, millage rates, per pupil funding levels and the property tax base over the past two decades.

Per the policy of the IFO, this report will be posted to the office website no later than three days following transmittal. The IFO welcomes any questions, comments or suggestions regarding the contents and methodology of this analysis.

Sincerely,

MATTHEW KNITTEL
Director

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Table of Contents

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Introduction

Property taxes serve as the primary source of funds for local units of government. For fiscal year (FY) 2010-11, data from the U.S. Census Bureau show that property taxes comprised nearly half (47.4 percent) of local government revenues and three quarters (74.2 percent) of total local taxes.[1] School districts also rely heavily on property taxes. For FY 2010-11, U.S. Census data show that property taxes comprised roughly two-thirds of total school district revenues.

Some states have implemented reform measures to reduce their reliance on local property taxes as a source of funding for K-12 schools. These measures typically shift funding to a major tax source levied at the state level, such as sales and use or personal income taxes. A well-known example of such reform is Michigan's Proposal A. In 1993, the Michigan legislature eliminated all local property taxes used to fund operating expenses for K-12 schools, but an alternative funding source was not identified. In March 1994, Michigan voters approved a referendum known as Proposal A, which replaced most local property taxes used for school operating purposes with higher sales and use and tobacco taxes and a new uniform statewide property tax.

This brief analysis describes the tax and funding changes implemented by Proposal A. The analysis uses data published by various Michigan executive and legislative agencies to quantify the impact of property tax reform on tax revenues, millage rates, per pupil funding levels and the property tax base. To assist policymakers in their deliberations of property tax reform proposals for Pennsylvania, the analysis examines historical data to illustrate the impact that property tax reform had on Michigan over the past two decades. It is noted that potential outcomes for Pennsylvania could be very different than Michigan because proposed reforms are not identical to those implemented under Proposal A. Moreover, due to the contraction of the auto industry, Michigan economic activity was significantly weaker than the rest of the country, or what might be expected under "normal" conditions. From 2003 to 2012, Michigan real gross state product (GSP) contracted at an average rate of 0.9 percent per annum.[2] By comparison, Pennsylvania real GSP expanded at an average rate of 0.9 percent per annum during that time period.

This brief report proceeds as follows. The first section provides background on the tax and funding changes implemented by Proposal A. The second section discusses historical revenue trends for the Michigan School Aid Fund. That fund uses earmarked revenues to make per pupil foundation allowance grants to local school districts. The third section presents per pupil revenue and foundation allowance trends. The fourth section discusses the impact of Proposal A on statewide average millage rates and the growth in millages levied for debt purposes. The fifth section discusses the impact of tax reform on the Michigan property tax base. A brief summary concludes the analysis.

[1] Figures exclude any intergovernmental grants. Data are available at http://www.census.gov/govs/local/.
[2] Gross State Product is a measure of the total output of a state economy. When measured in real terms, the measure excludes the impact of inflation.

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Overview of Michigan Property Tax Reform

In August 1993, the Michigan legislature passed Public Act 145 of 1993. The Act eliminated $6.9 billion of local school property taxes used to fund operating expenses for K-12 and intermediate school districts, but did not provide an alternate funding source. Several factors motivated this dramatic action:

- Michigan relied more heavily on local property taxes than other states. For 1993, the ratio of Michigan property taxes to state personal income ranked 7th highest in the nation. Relative to the average U.S. property taxpayer, Michigan property owners paid nearly one-third more in property taxes.[3] Most of the property tax levy was used for local schools. For the 1992-93 school year, approximately 61.4 percent of total local school revenues (including debt) originated from local and intermediate sources (i.e., local property taxes). Only three states relied more heavily on local property taxes to fund K-12 schools: New Hampshire (86.6 percent), Illinois (62.0 percent) and Vermont (61.6 percent). For the U.S., property taxes comprised 44.7 percent of local school revenues.[4]
- For 1992, Michigan implemented a statewide freeze on property tax assessments. Many residents incurred a double-digit increase in their property tax assessment in the following year and were receptive to tax reform.
- Residents were dissatisfied with per pupil expenditure disparities that existed across school districts.[5] Tax reform consolidated school funding and facilitated a method to reduce those disparities.

In December 1993, the governor approved legislation that established a new formula to fund K-12 schools. Revenue from the School Aid Fund (SAF) would be distributed to local schools through a per pupil foundation allowance. However, the funding sources for the SAF were not identified at that time.

To determine those funding sources, a March 1994 referendum presented Michigan voters with two options: Proposal A (a yes vote) or the Statutory Plan (a no vote). Table 1 lists the main parameters of the two plans. Proposal A relied on increases in sales and use taxes (2.0 percentage points), a new State Education Tax or SET (6.0 mills) levied statewide on all property and a local levy on nonhomestead property (18.0 mills for most school districts).[6] The Statutory Plan relied on increases in personal income taxes (1.4 percentage points), a new SET levied on nonhomestead property (12.0 mills) and a local levy

[3] These measures are common "tax burden" measures that analysts use to compare tax revenues across states.
[4] All computations from the Michigan Department of Treasury. See "School Finance Reform in Michigan, Proposal A: A Retrospective," (Dec. 2002) at http://www.michigan.gov/documents/propa_3172_7.pdf?2013090414405.
[5] For FY 1993-94, per pupil state and local revenues ranged from $3,398 to $10,294.
[6] One mill is equal to a tax rate of 0.1 percent or 0.001. A one mill tax levied on a home with an assessed value of $200,000 implies a tax levy of $200. In Michigan, property is assessed at 50 percent of market value.

on all property (12.0 mills).[7] Both plans increased the cigarette excise tax, implemented a new state realty transfer tax and a created a new distinction between homestead and nonhomestead property. Proposal A also included an annual cap on increases in property tax assessments at the lesser of five percent or the rate of inflation, excluding any new taxable construction. The assessment value would reset to the uncapped base (50 percent of market value) upon sale of the home.

In March 1994, Michigan voters approved Proposal A by a 69 to 31 margin. Analysts credited the wide margin of victory to four factors: (1) a preference for sales taxes relative to income taxes, (2) a larger reduction in millage rates for homeowners under Proposal A, (3) anti-tobacco sentiment and (4) the annual cap on property tax assessments.

Table 1
Funding Alternatives for Local School Operating Levies

		1994 Voter Options	
Tax Source	**1993 Tax Law**	**Proposal A**	**Statutory Plan**
Sales and Use	4.00%	6.00%	4.00%
Personal Income	4.60%	4.40%	6.00%
Personal Exemption	2,100	2,100	3,000
Single Business Tax[1]	2.35%	2.35%	2.75%
Cigarettes (cents per pack)	25	75	40
Other Tobacco	none	16.00%	16.00%
State Realty Transfer	none	0.75%	1.00%
State Education Tax (mills)			
Homestead	none	6.0	0.0
Nonhomestead	none	6.0	12.0
Local School Operating (mills)			
Homestead[2]	34.0	0.0	12.0
Nonhomestead[2]	34.0	18.0	12.0
Annual Cap on Property Value	none	5% or inflation	none
Local Option[3]	none	up to 3 mills	up to 3 mills

[1] The Single Business Tax was a tax on a firm's "value added." Value added generally includes wages and salaries (roughly 75 percent of the tax base), business income, depreciation, rent and interest.
[2] Statewide averages. Homestead property refers to an occupied home that serves as a primary residence or agricultural property. Nonhomestead property includes all property not classified as homestead.
[3] The Local Option allows local units to levy additional mills for a specified period of time if approved by voters.

[7] Nonhomestead property includes all property that does not serve as a primary residence such as industrial and commercial property and vacation homes. The local levy on nonhomestead property is effectively a statewide levy because the rate is the same across all local units. The levy is referred to as a local levy because it is collected and retained by local units.

The new funding system was first used for state FY 1994-95, which largely corresponds to the 1994-95 Michigan school year.[8] Major funding changes include:[9]

- Public Act 145 exempts all property from local and intermediate school district operating millages, but does not affect debt and building-site millages that are levied separately. Community college millages are also unaffected by the Act.
- Michigan abandoned the power-equalization system for a per pupil foundation allowance system.[10] The foundation allowance is the per pupil funding amount approved annually by the Michigan legislature for each school district. Districts generally cannot spend more than that amount for operating purposes.[11]
- For 1994-95, the foundation allowance was based on each district's per pupil revenues for 1993-94. A minimum level was established at $4,200 per pupil in combined state and local funds and all districts received an increase of at least $160 over their per pupil revenue from the prior year. Most school districts (approximately 93 percent) had a foundation allowance above that minimum. The maximum foundation allowance was $6,500 and the weighted average was $5,492. (Discussed further in next section.)
- The proceeds from the local 18 mill property tax on nonhomestead property are retained locally and applied to the per pupil foundation allowance. The state then provides any additional funds necessary to achieve the specified foundation allowance. For 1994-95, the maximum foundation allowance was set at $6,500. State funds could be used to bring districts up to that level, but not beyond. The legislature determines the cutoff threshold annually.
- For FY 1994-95, if a district's foundation allowance exceeded the $6,500 threshold, then additional funds may be raised locally through "hold harmless" mills to achieve the foundation allowance. Higher-spending districts were allowed to levy those mills on homestead property to maintain spending levels. Voters must approve those levies and they must be renewed every ten years.[12] Nearly 10 percent of districts were above the $6,500 threshold and were eligible to levy hold harmless mills. Nearly all voted to impose the optional levy.

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[8] The Michigan fiscal year ends in September and the school fiscal year ends in June.

[9] For a complete discussion of changes, see "State and Local Revenues for Public Education in Michigan," Citizens Research Council (September 2010) at http://crcmich.org/PUBLICAT/2010s/2010/rpt363.html.

[10] The power equalization system allows each school district to determine its own level of school funding. However, poorer districts receive assistance so that they obtain the same revenue per student as a comparable district if they make a similar tax effort based on millage rates and their property tax base. Foundation grant systems provide a guaranteed level of per pupil funding.

[11] The exceptions are districts where the 18 mill local levy on nonhomestead property exceeds the foundation allowance (and so do not require any state funds) and hold harmless districts.

[12] Hold harmless millages are first levied on homestead property up to 18 mills. After that point, they are levied on all property. Currently, no districts levy hold harmless millage on nonhomestead property.

- For FY 1995-96 and later years, a per pupil funding floor was established. The floor is equal to each local school district's combined state and local per pupil operating revenues for FY 1994-95.[13]
- There is no guaranteed annual increase in per pupil funding levels that the state must provide, as long as per pupil state and local revenues exceed each district's revenues for FY 1994-95. Hence, the Michigan legislature has considerable discretion over revenues in excess of the FY 1994-95 funding floor.

[13] Article IX, Section 11 of the Michigan Constitution states that "Beginning in the 1995-96 state fiscal year and each state fiscal year after 1995-96, the state shall guarantee that the total state and local per pupil revenue for school operating purposes for each local school district shall not be less than the 1994-95 total state and local per pupil revenue for school operating purposes for that local school district, as adjusted for consolidations, annexations, or other boundary changes. However, this guarantee does not apply in a year in which the local school district levies a millage rate for school district operating purposes less than it levied in 1994."

The Michigan School Aid Fund

The Michigan School Aid Fund (SAF) includes revenues from many tax sources. Major earmarked revenue sources include: (1) a portion of the personal income tax, (2) 60.0 percent of the sales and use tax levied at the original 4.0 percent rate, (3) all sales and use tax levied under the 2.0 percent rate increase enacted by Proposal A, (4) one-third of the 12.0 percent liquor excise tax, (4) 41.6 percent of the cigarette excise tax, (5) all casino gaming tax revenues (8.1 percent rate, implemented in 1999), (5) all of the new SET (levied statewide on all taxable property), (6) all new state real estate transfer taxes, (7) all Lottery net proceeds and (8) other miscellaneous revenues.[14]

Table 2 provides an itemization of the various tax sources earmarked to the Michigan SAF. Many tax sources have not changed since the implementation of Proposal A, but there are some notable exceptions:

- For CY 1996 and FY 1996-97, the personal income tax earmark to the SAF was increased from 14.0 to 23.0 percent. In 1999, another policy change ensured that the SAF would be held harmless for changes in the personal income tax rate. The revised income tax earmark was set to equal 1.012 / tax rate. A subsequent tax rate reduction (4.4 to 3.9 percent) caused the earmark to increase to 25.95 percent. In 2012, the income tax rate increased to 4.25 percent, and the earmark fell to its current level of 23.8 percent.
- The cigarette excise tax increased from $0.75 per pack to $1.25 in 2002 and $2.00 in 2004. Various portions of those tax increases have been earmarked to the SAF.
- Effective for CY 2008 and later years, industrial personal property was exempted from the 18 mill local school tax and commercial personal property was exempted from most of that levy (12 of the 18 mills). Industrial personal property was also exempted from the statewide 6 mill SET. The Michigan Senate Fiscal Agency estimates that those changes reduced property tax revenues dedicated to finance education by roughly $479 million for FY 2008-09.[15]
- To offset that reduction (and others), lawmakers earmarked revenues from the Michigan Business Tax to the SAF. For FY 2008-09, the earmark to the SAF was set at $729 million and would increase with inflation beginning in FY 2009-10.
- For FY 2011-12, the legislature repealed the Michigan Business Tax, and replaced it with a corporate net income tax. That reform eliminated all business tax transfers to the SAF.
- In 1996, Michigan legalized casino gaming for Detroit. Casinos became operational in 1999. All non-tribal casino gaming revenues are deposited into the SAF.

[14] The sales and use tax earmarks are Constitutional, all other earmarks are statutory.

[15] See Michigan Senate Fiscal Agency website at http://www.legislature.mi.gov/documents/2007-2008/billanalysis/Senate/pdf/2007-SFA-0094-E.pdf. Most of those revenues were local revenues that were applied to the foundation allowance. The tax cut for local units implied that the state must fund a higher share of the foundation allowance.

Table 2
The Michigan School Aid Fund
($ millions)

	Tax and Lottery Sources									Other Revenues				
FYE	**Sales and Use**	**Income Tax**	**State Education**	**Realty Transfer**	**Tobacco Tax**	**Business Tax**	**Lottery**	**Casino-Other[1]**	**Sub-total**	**General Fund**	**Federal Funds[2]**	**Other Revs[3]**	**TOTAL SAF[4]**	**Detroit CPI-U**
1993	$1,743	$0	$0	$0	$20	$0	$428	$75	$2,265	$1,086	$57	$2	$3,411	136.0
1994	2,662	0	447	0	163	0	511	122	3,904	710	63	0	4,676	139.7
1995	3,884	883	1,065	91	397	0	548	144	7,010	665	63	0	7,739	144.3
1996	4,121	918	1,111	161	371	0	548	163	7,393	596	70	204	8,264	148.8
1997	4,296	1,583	1,156	193	351	0	588	154	8,319	278	70	23	8,690	152.7
1998	4,481	1,699	1,257	228	363	0	616	153	8,796	376	85	229	9,486	156.4
1999	4,729	1,848	1,274	262	394	0	621	182	9,310	420	107	113	9,950	160.0
2000	5,030	1,968	1,381	257	388	0	619	246	9,889	420	122	48	10,479	164.1
2001	5,076	1,955	1,490	253	383	0	587	250	9,994	386	149	149	10,677	170.0
2002	5,131	1,860	1,584	253	404	0	614	289	10,134	198	183	396	10,912	174.5
2003	5,092	1,848	2,128	276	489	0	586	297	10,715	249	1,070	185	12,219	179.2
2004	5,156	1,894	1,825	318	485	0	645	294	10,615	378	1,257	11	12,261	182.6
2005	5,273	1,986	1,915	314	473	0	668	283	10,910	164	1,322	54	12,450	185.6
2006	5,290	2,039	2,004	298	472	0	688	292	11,082	63	1,359	70	12,574	191.2
2007	5,229	2,110	2,081	238	450	0	749	296	11,153	34	1,382	483	13,052	196.7
2008	5,387	2,118	2,080	170	425	341	741	252	11,513	29	1,378	6	12,926	200.3
2009	4,845	1,895	2,041	125	410	677	725	204	10,922	77	2,104	19	13,122	204.7
2010	5,009	1,836	1,931	122	393	604	701	221	10,817	28	2,393	3	13,241	203.7
2011	5,373	1,973	1,845	123	376	612	727	219	11,248	19	2,178	21	13,466	205.2
2012	5,470	2,100	1,790	150	374	0	778	217	10,879	79	1,819	65	12,842	212.1
2013[5]	5,579	2,347	1,792	191	367	0	745	213	11,213	282	1,701	0	13,197	216.2
Average Annual Growth Rate														
1997-2013	1.6%	2.4%	2.8%	-0.1%	0.3%	n.a.	1.5%	2.1%	1.9%	n.a.	22.0%	n.a.	2.6%	2.2%
1997-2002	3.6%	3.3%	6.5%	5.6%	2.9%	n.a.	0.9%	13.4%	4.0%	n.a.	21.1%	n.a.	4.7%	2.7%
2002-2008	0.8%	2.2%	4.6%	-6.4%	0.9%	n.a.	3.2%	-2.2%	2.1%	n.a.	40.0%	n.a.	2.9%	2.3%
2008-2013	0.7%	1.9%	-2.9%	2.3%	-2.9%	n.a.	0.1%	-3.3%	-0.5%	n.a.	4.3%	n.a.	0.4%	1.5%

[1] Includes casino gaming, liquor excise and the industrial-commercial facilities tax (state 6 mill portion only).
[2] Federal Funds include the following ARRA amounts for FY 2008-09 to FY 2010-11: $600 million, $450 million and $184 million.
[3] Other Revenues include one-time funds such as the securitization of tobacco settlement monies ($200 million for FY 2006-07) and transfers from the rainy day fund ($350 million for FY 2001-02).
[4] Excludes all local property tax levies applied to the foundation allowance.
[5] FY 2012-13 is an estimate from the Michigan Consensus Revenue Estimating Conference.

Sources: Michigan Comprehensive Annual Financial Report (various years), Michigan Department of Treasury and Michigan Senate Fiscal Agency.

Although the Michigan SAF relies on many funding sources, three taxes comprise the great majority (roughly 85 percent) of revenues deposited into the fund: personal income tax, sales and use tax and the SET. The growth of the SAF and per pupil funding levels will be dependent upon those revenue sources. The bottom of Table 2 displays average annual growth rates for all SAF funding sources since FY 1996-97 (the first full year of the higher income tax earmark), as well as three subintervals that correspond to economic cycles. For comparative purposes, the far right column displays the CPI-U for the Detroit metro area.[16] Notable trends include:

- Since FY 1996-97, the average growth rate of earmarked sales and use taxes (1.6 percent per annum) has underperformed inflation (2.2 percent).
- The average growth rate of income tax revenues (2.4 percent per annum) has slightly outperformed inflation. A minor income tax rate reduction (4.4 to 4.25 percent) contributes to that relatively low growth rate.
- The average growth rate of the SET (2.8 percent per annum) exceeds inflation, but shrank dramatically since FY 2007-08, largely due to the collapse in home values (which are quickly reflected in the Michigan property tax base).[17]
- The average growth rate of all SAF tax and lottery revenues (1.9 percent per annum) has not kept pace with inflation. Since FY 2007-08, the average growth rate of SAF tax and lottery revenues has been negative (-0.5 percent).
- General Fund grants to the SAF are discretionary and depend on per pupil funding levels desired by policymakers.
- Federal Funds increased significantly in FY 2002-03 due to the federal No Child Left Behind Act. For FY 2008-09 to FY 2010-11, federal grants also include American Recovery and Relief Act (ARRA) funds and federal education job funds.
- Other Revenues include miscellaneous revenues such as tobacco settlement securitization monies ($200 million in FY 2006-07) and a one-time transfer from the Economic and Budget Stabilization Fund (Michigan's rainy day fund, $350 million in FY 2001-02).
- The average growth rate of all SAF revenues (2.6 percent per annum) has outperformed inflation due to the large increase in federal funds. However, since FY 2007-08, total SAF revenues (0.4 percent) have not kept pace with inflation (1.5 percent).

[16] The Detroit CPI-U is the consumer price index for all urban consumers in the Detroit metro area. It measures the annual increase in price levels for a typical basket of goods purchased by consumers.
[17] A new exemption for industrial personal property also had a minor impact on these revenues.

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Per Pupil Revenues and Foundation Allowances

The data from Table 2 detail the total revenues deposited into the School Aid Fund (SAF). However, a complete assessment of the impact of Proposal A on school funding should also consider trends in per pupil funding levels. Table 3 displays real and nominal SAF revenues, pupil membership for school districts and charter schools and real and nominal per pupil revenues.[18] Real values exclude inflation, as measured by the Detroit CPI-U, and all real dollar amounts are expressed in 2013 dollars. Per pupil revenues equal total SAF revenues divided by total pupil membership. As noted previously, local school districts first apply their 18 mill local levy on nonhomestead property towards the per pupil foundation allowance. State revenues are then used to make up the difference to achieve the foundation allowance for each school district (up to the applicable maximum or cutoff threshold). Local revenues are not included in the SAF revenues from Tables 2 or 3.

The columns on the right hand side of Table 3 display the minimum and maximum foundation allowance levels and the effective maximum. The minimum allowance is the per pupil floor set each year by the Michigan legislature. A district's foundation allowance includes both mandatory ($4,200, or the per pupil amount a school district received for FY 1994-95) and discretionary (amounts above those floors) funding. The maximum allowance is the highest possible foundation allowance that can receive state funds; a foundation allowance which exceeds that amount must use local revenues to generate the incremental funds. Two types of school districts may exceed the maximum allowance: (1) those who do not need any state funds (i.e., the local 18 mill levy on nonhomestead property generates all funds) and (2) high-spending hold harmless districts.[19] The effective maximum is the highest foundation allowance in the state. The final columns display the nominal (includes inflation) and real weighted average per pupil foundation allowance across all school districts. Notable results include:

- Since FY 1996-97, the Michigan pupil population has declined at an average rate of 0.4 percent per annum.
- For the same time period, nominal per pupil SAF revenues increased by 3.1 percent per annum and real per pupil SAF revenues increased by 0.9 percent per annum. Since FY 2007-08, the respective average growth rates have been much lower (1.9 and 0.3 percent per annum).
- The difference between the minimum and maximum foundation allowance has narrowed over time. For FY 1994-95, the minimum was 64.6 percent of the maximum. For FY 2012-13, the ratio is 86.9 percent. The foundation allowance formula constrains per pupil spending by

[18] In addition to tax and funding reforms, Proposal A implemented "schools of choice" and charter schools. Under Proposal A, the per pupil foundation allowance is based on the residence of the student, and the allowance follows a student to their school of choice, assuming that the school district accepts schools of choice students and has sufficient capacity to accommodate the students.
[19] For FY 2012-13, 44 out of 805 school districts and charter schools had a foundation allowance that exceeds the maximum. Some contain less than one hundred students.

wealthier school districts, but allows poorer districts to grow at a rate that is faster than the statewide average. A small number of districts levy local hold harmless millages on homestead property and generate per pupil revenues above the maximum. Table 3 lists the highest foundation allowance for each year (the effective maximum).

- Although Proposal A amended the Michigan Constitution, it did not restrict the use of the SAF to K-12 education. In FY 2009-10, $208.4 million of SAF revenue was diverted to community colleges. Beginning with FY 2011-12, roughly $400 million of SAF revenue has been appropriated annually for community colleges and colleges/universities.[20]
- Since FY 2007-08, the diversion of revenues from the SAF has caused the real weighted average foundation allowance (-2.7 percent per annum) to grow much slower than real per pupil revenues (0.3 percent per annum). The diversion of revenues for debt service (discussed in next section) and pensions has also contributed to that outcome.
- Since FY 1996-97, the weighted average nominal foundation allowance has increased by 1.4 percent per annum, but the real allowance has declined by 0.8 percent per annum. The long-term decline of the real foundation allowance is due to revenue diversion, low growth of revenue sources (notably sales tax), specific tax cuts (e.g., elimination of personal property from the local 18 mill nonhomestead levy and 6 mill SET) and, to a lesser extent, the expiration of hold harmless millage levies by a small number of school districts.

It is noted that the revenue data from Tables 2 and 3 will not equal total operational expenditures for any given year. Certain operating expenditures such as at-risk funding and school lunches are technically operating expenditures, but those specific expenses receive funding through other means.

[20] For FY 2013-14, $398 million was appropriated for community colleges ($197 million) and colleges and universities ($201 million).

Table 3
School Aid Fund Revenues and Foundation Allowance
($ millions)

	Total SAF Revenues[1]		Pupil Membership			Per Pupil Revenues[1]		Per Pupil Foundation Allowance[2]				
											Weighted Average[4]	
FYE	Nominal Dollars	Real Dollars[3]	School Districts	Charter Schools	Total	Nominal Dollars	Real Dollars[3]	Minimum	Maximum	Effective Maximum	Nominal	Real[3]
1995	$7,739	$11,598	1,593,306	0	1,593,306	$4,857	$7,279	$4,200	$6,500	$10,454	$5,492	$8,231
1996	8,264	12,010	1,610,130	4,790	1,614,920	5,117	7,437	4,506	6,653	10,607	5,685	8,263
1997	8,690	12,303	1,634,074	11,520	1,645,594	5,281	7,476	4,816	6,808	10,762	5,875	8,318
1998	9,486	13,115	1,651,011	19,202	1,670,213	5,680	7,853	5,124	6,962	10,916	6,061	8,379
1999	9,950	13,449	1,656,186	31,109	1,687,295	5,897	7,971	5,170	6,962	10,916	6,064	8,197
2000	10,479	13,804	1,651,300	45,290	1,696,590	6,177	8,137	5,700	7,200	11,154	6,336	8,346
2001	10,677	13,577	1,649,085	55,072	1,704,157	6,265	7,967	6,000	7,500	11,154	6,640	8,444
2002	10,912	13,521	1,647,459	62,113	1,709,572	6,383	7,909	6,500	7,800	11,754	7,013	8,690
2003	12,219	14,742	1,647,531	67,336	1,714,867	7,125	8,597	6,626	8,000	11,880	7,246	8,743
2004	12,261	14,518	1,640,929	73,473	1,714,402	7,152	8,468	6,626	8,000	11,880	7,173	8,493
2005	12,450	14,503	1,626,289	81,491	1,707,780	7,290	8,492	6,700	8,000	11,954	7,247	8,443
2006	12,574	14,222	1,607,880	89,654	1,697,534	7,407	8,378	6,875	8,175	12,129	7,422	8,395
2007	13,052	14,344	1,584,435	96,627	1,681,062	7,764	8,533	7,108	8,385	12,339	7,632	8,387
2008	12,926	13,953	1,553,568	98,987	1,652,555	7,822	8,443	7,204	8,433	12,387	7,738	8,353
2009	13,122	13,862	1,517,714	102,030	1,619,744	8,101	8,558	7,316	8,489	12,443	7,827	8,269
2010	13,241	14,051	1,487,297	108,425	1,595,722	8,298	8,806	7,162	8,489	12,170	7,640	8,108
2011	13,466	14,189	1,457,160	112,276	1,569,436	8,580	9,041	7,146	8,489	12,154	7,625	8,035
2012	12,842	13,093	1,432,200	119,900	1,552,100	8,274	8,436	6,846	8,019	11,854	7,323	7,466
2013	13,197	13,197	1,406,100	130,500	1,536,600	8,588	8,588	6,966	8,019	11,854	7,293	7,293
Average Annual Growth Rate												
1997-2013	2.6%	0.4%	-0.9%	16.4%	-0.4%	3.1%	0.9%	2.3%	0.6%	n.a.	1.4%	-0.8%
1997-2002	4.7%	1.9%	0.2%	40.1%	0.8%	3.9%	1.1%	6.2%	1.8%	n.a.	3.6%	0.9%
2002-2008	2.9%	0.5%	-1.0%	8.1%	-0.6%	3.4%	1.1%	1.7%	0.9%	n.a.	1.7%	-0.7%
2008-2013	0.4%	-1.1%	-2.0%	5.7%	-1.4%	1.9%	0.3%	-0.7%	-0.9%	n.a.	-1.2%	-2.7%

[1] State funds only. Excludes any local revenues from the 18 mill tax on nonhomestead property or hold harmless millages.
[2] The Minimum Foundation Allowance is the minimum amount approved by the Michigan legislature for a given year. The Maximum Foundation Allowance is the maximum amount that can be supported with state funds. The Effective Maximum is the highest foundation allowance for a given year and must use local funds for amounts over the maximum.
[3] Real amounts expressed in 2013 dollars.
[4] Pupil weighted average foundation allowance.

Source: School Aid Fund data from the Michigan Senate Fiscal Agency. Pupil membership from the Michigan Department of Education. Effective Minimum and Maximum and Weighted Average Foundation Allowances from the Michigan Senate Fiscal Agency.

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Statewide Average Millage Rates and Debt Issuance

Proposal A had a dramatic impact on Michigan millage rates. Table 4 displays historical statewide average millage rates for various entities that levy property tax. (Note: Table 4 uses five-year increments except the first and last years, which represent the pre-Proposal A level and the latest data available.) Notable trends include:

- Average statewide millage rates fell dramatically from 1993 to 1995 (-31.4 percent) due to a significant reduction in local school operating mills.
- Since 1995, average statewide millage rates have increased slightly from 38.9 to 40.4 mills. The increase is attributable to levies by municipalities (0.6 mills) and debt and building/site mills (2.1 mills).
- The annual cap on property tax assessments likely caused some increase in millage rates (discussed in next section).
- Since 1995, local school operating mills have further declined by 2.2 mills. That outcome is attributable to two factors: (1) the expiration of up to three local school district enhancement mills that could be levied from 1994 to 1996 and (2) the increasing share of the property tax base comprised of homestead property, which is exempt from local school operating mills.

Table 4
Statewide Average Millage Rates

	1993	1995	2000	2005	2010	2012
Municipalities						
County	6.22	6.28	6.27	6.30	6.47	6.93
Township	3.36	3.68	4.09	4.36	4.48	4.24
City	15.45	15.95	16.36	16.39	16.93	17.86
Village	11.94	12.34	12.20	11.53	11.03	11.44
Subtotal	**15.89**	**16.23**	**16.37**	**16.15**	**16.31**	**16.81**
Schools						
Local Operating	33.91	9.26	8.41	7.78	7.14	7.08
Debt and Site	2.54	3.03	4.01	4.71	4.85	5.13
ISD / Comm. College[1]	4.30	4.36	4.51	5.24	5.40	5.40
State Education Tax	0.00	6.00	6.00	6.00	6.00	6.00
Subtotal	**40.75**	**22.65**	**22.93**	**23.73**	**23.39**	**23.61**
TOTAL	**56.64**	**38.88**	**39.30**	**39.88**	**39.70**	**40.42**
Local School Operating + SET	**33.91**	**15.26**	**14.41**	**13.78**	**13.14**	**13.80**

[1] Intermediate School Districts / Community College.

Source: Ad Valorem Property Tax Report (various years), Michigan State Tax Commission and Michigan Department of Treasury.

A notable result from Table 4 is the near doubling of the average statewide millage rate levied for debt and building/site purposes. Table 5 displays additional detail regarding levies by local school districts for debt and building/site purposes. The revenues from those levies are restricted and may only be used to service debt used for school construction, renovation, certain technology upgrades, playgrounds and other capital projects. The table shows the dollar amount of qualified school bonds that were placed on a referendum and the dollar amount passed. The bonds were issued under the Michigan Qualified School Bond and Loan program. Most local districts apply to the Department of Treasury to qualify proposed bonds for the program. If approved, districts may issue qualified bonds using the state's credit rating because the state guarantees repayment. Local districts may also borrow funds from the state for annual debt service that exceeds a 7 mill levy. When the debt has been retired, the district has 72 months to repay the loan to the state. For 2011, 426 out of 549 local school districts had outstanding bonds under the Qualified School Bond and Loan Program.[21]

Overall, the program reduces the cost to borrow funds for local units and allows them to levy a lower, and more stable, millage rate. However, the program also increases total debt service and the time period over which debt must be repaid, sometimes by more than 72 months. The state issues debt to finance the loans made to local districts to allow a lower millage rate to be levied. Revenues from the SAF are used to service that state debt. For FY 2012-13, debt service payments for that purpose will total $120 million. Hence, the dramatic growth of this program creates additional pressure for local school funding levels.

Following passage of Proposal A (March 1994), there was a significant increase in votes and approvals for issuance of new debt under the program. (See Table 5.) The final column of Table 5 displays the amount of qualified bonds outstanding at the end of the calendar year. The data show that outstanding qualified bonds roughly doubled from 1993 ($3.8 billion) to 1997 ($7.3 billion) and then doubled again from 1997 to 2010 ($14.4 billion). Since 2010, outstanding debt has declined.

[21] For more detail regarding this program and its interaction with the Michigan SAF, see "School Capital Expenditure Finance in Michigan: Issues and Alternatives," Senate Fiscal Agency (November 2012).

Table 5
School Bond Loan Qualification Bonds Voted and Passed
($ millions)

Calendar Year	Amount Voted	Amount Passed	Share Passed	Amount Outstanding
1992	$789	$309	39.2%	$3,801
1993	654	217	33.2	3,818
1994[1]	2,832	1,999	70.6	4,081
1995	2,787	1,252	44.9	5,001
1996	2,377	1,295	54.5	6,271
1997	2,636	1,351	51.2	7,296
1998	2,232	799	35.8	8,176
1999	1,926	958	49.8	8,759
2000	2,478	1,399	56.5	9,774
2001	2,341	1,318	56.3	11,215
2002	1,737	1,042	60.0	12,202
2003	2,475	988	39.9	12,866
2004	2,449	1,633	66.7	13,800
2005	1,390	569	41.0	13,506
2006	1,629	511	31.3	13,933
2007	1,419	710	50.0	14,033
2008	849	535	63.0	14,051
2009	1,505	1,097	72.9	14,131
2010	1,118	698	62.4	14,371
2011	1,012	332	32.8	14,013
2012	613	291	47.5	13,622

[1] The 1994 total includes one issue in the amount of $1.5 billion for Detroit Public Schools.

Source: Michigan Department of Treasury, Bureau of State and Authority Finance, School Bond Qualification and Loan Program, 2012 Annual Report.

The significant increase in debt issuance and millages for debt purposes is likely an unintended outcome of Proposal A. Due to limitations imposed by the foundation allowance system, school districts cannot unilaterally increase their per pupil revenues. Moreover, many school districts realized a reduction in their student population. To maintain total funding levels, those districts may attempt to attract students who reside outside the school district because the per pupil foundation allowance follows the student to their school of choice. In order to attract new students, some school districts have elected to compete through facility upgrades and have borrowed funds to achieve that end. School districts strive to maintain funding levels because certain costs incurred by school districts cannot immediately adjust to reflect lower student enrollment, or may even increase. Examples include teacher contracts, health and pension costs and gas and heating expenses.

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The Michigan Property Tax Base

Proposal A implemented a cap on the annual increase in state equalized value (the former property tax base) at the lesser of five percent or inflation. The cap applies to each individual property that is assessed. The capped base is referred to as taxable value. If a property is sold, then taxable value reverts to state equalized value, which is equal to one-half the market value of the property.

Table 6 displays the impact of the annual assessment cap on the Michigan property tax base. Notable trends include:

- For 2013, the cap reduced the Michigan property tax base by $33.5 billion.[22]
- The impact of the cap peaked in 2007, reducing the property tax base by $96.1 billion. From that point, the impact declined due to the crash of the housing market.
- State equalized value and taxable value increased very rapidly after Proposal A. The data reveal that those tax bases increased much more rapidly than average home prices for the U.S. and Pennsylvania.

To illustrate this final point, Table 7 displays data from the U.S. Federal Finance Housing Authority. That agency publishes home price indices for the U.S. and all states. Those indices reflect the average change in the market value of homes sold and unsold. Notable trends include:

- During the time period immediately following passage of Proposal A (1994-2001), the U.S. home price index (HPI) increased at an average rate of 4.7 percent per annum. For Michigan and Pennsylvania, the respective values were 6.8 percent and 2.7 percent.
- The strong growth of the Michigan HPI is reflected in the growth of the uncapped property tax base from Table 6. From 1994-2001, Michigan state equalized value increased at an average rate of 8.6 percent per annum.
- For the time period following the 2001 recession (2001-2007), average Michigan HPI growth (0.4 percent per annum) was substantially weaker than Pennsylvania (8.1 percent) and the U.S. (6.8 percent).
- The weakness accelerated through 2012, as the Michigan HPI declined at an average rate of 4.0 percent per annum.

[22] For 2013, agricultural property comprises roughly five percent of total Michigan state equalized value but receives approximately 26 percent of the taxable value cap benefit. When farmland property is resold, the taxable value does not reset to state equalized value if the land remains in agricultural production.

Figure 1 illustrates the robust housing market in Michigan following the implementation of Proposal A relative to the U.S. and Pennsylvania. A portion of that strong growth is attributable to the policy changes enacted by Proposal A. Research suggests that property tax cuts are "capitalized" into the value of homes over many years. Under capitalization, home values increase due to the lower future stream of property tax payments.

Table 6
Impact of Property Tax Assessment Cap
($ billions)

Tax	State Equalized Value		Taxable Value		Difference	
Year	**Amount**	**Growth**	**Amount**	**Growth**	**Dollar**	**Percent**
1993	$167.7		$167.7		$0.0	0.0%
1994	175.2	4.4%	175.2	4.4%	0.0	0.0
1995	186.4	6.4	182.1	4.0	-4.3	-2.3
1996	200.3	7.5	191.7	5.2	-8.7	-4.5
1997	216.7	8.2	202.6	5.7	-14.1	-7.0
1998	237.4	9.5	215.2	6.2	-22.2	-10.3
1999	261.0	9.9	228.1	6.0	-32.9	-14.4
2000	284.4	9.0	240.6	5.5	-43.8	-18.2
2001	312.9	10.0	257.7	7.1	-55.2	-21.4
2002	343.7	9.8	274.7	6.6	-69.1	-25.1
2003	369.5	7.5	289.0	5.2	-80.6	-27.9
2004	392.6	6.3	304.7	5.5	-87.9	-28.8
2005	415.8	5.9	321.7	5.6	-94.1	-29.3
2006	436.4	5.0	340.3	5.8	-96.1	-28.2
2007	453.1	3.8	357.3	5.0	-95.8	-26.8
2008	448.1	-1.1	363.2	1.7	-84.9	-23.4
2009	423.9	-5.4	360.6	-0.7	-63.3	-17.6
2010	385.1	-9.2	336.8	-6.6	-48.2	-14.3
2011	362.8	-5.8	323.6	-3.9	-39.2	-12.1
2012	349.3	-3.7	315.8	-2.4	-33.5	-10.6
Annual Average Growth Rate						
1994-2012		3.9%		3.3%		n.a.
1994-2001		8.6		5.7		n.a.
2001-2007		6.4		5.6		n.a.
2007-2012		-5.1		-2.4		n.a.

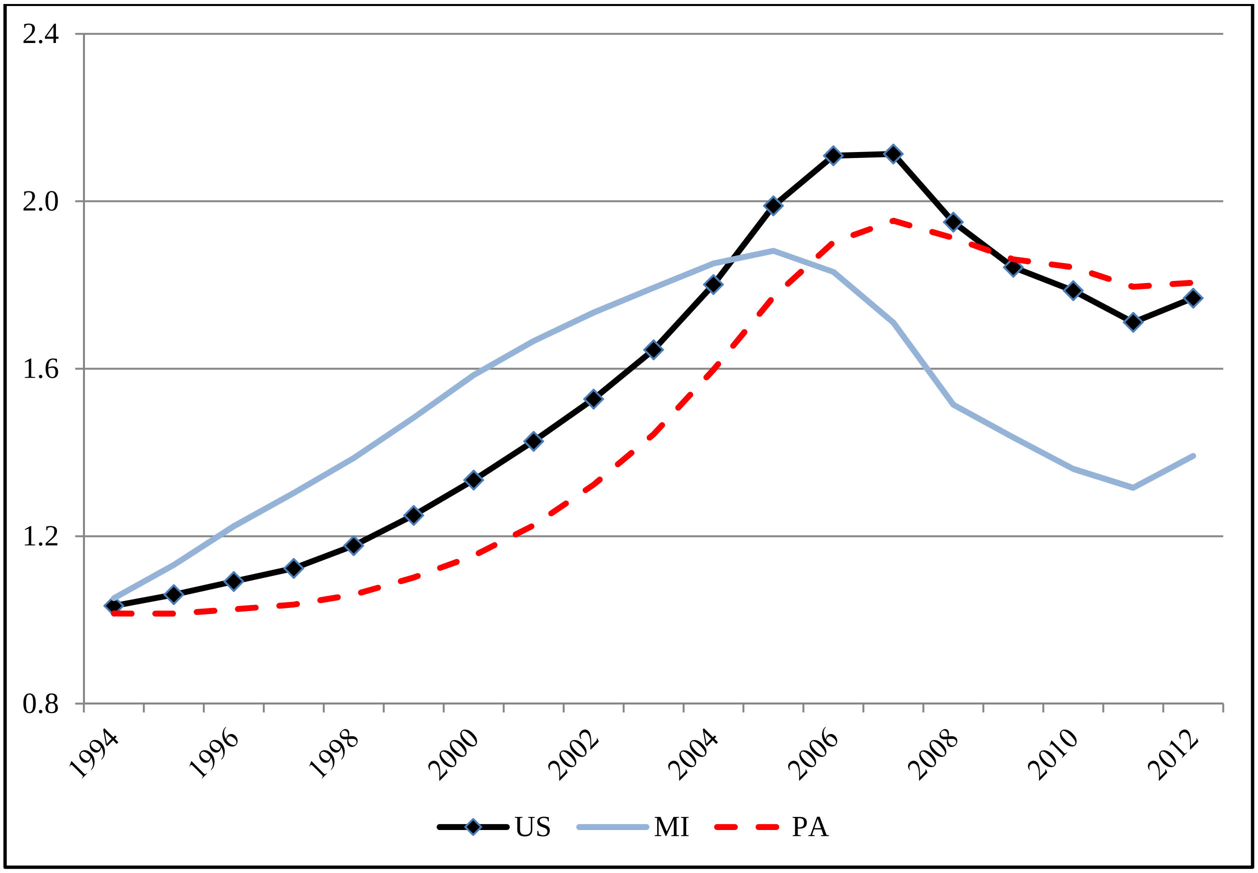
Source: Ad Valorem Property Tax Report (various years), Michigan State Tax Commission.

Table 7
Home Price Indices

CY	US	MI	PA
1993	105.3	107.6	103.3
1994	108.9	113.2	104.8
1995	111.7	121.7	104.8
1996	115.0	131.7	105.9
1997	118.3	140.2	107.1
1998	124.1	149.2	109.5
1999	131.7	159.5	113.7
2000	140.5	170.5	119.1
2001	150.3	179.3	126.6
2002	160.9	186.5	136.6
2003	173.3	192.9	149.0
2004	189.7	199.2	165.0
2005	209.6	202.4	182.9
2006	222.2	197.0	196.4
2007	222.6	183.9	201.7
2008	205.4	162.9	197.4
2009	194.1	154.5	192.2
2010	188.2	146.4	190.2
2011	180.2	141.5	185.4
2012	186.3	149.7	186.5
Average Annual Growth Rate			
1994-2012	3.2%	1.9%	3.3%
1994-2001	4.7%	6.8%	2.7%
2001-2007	6.8%	0.4%	8.1%
2007-2012	-3.5%	-4.0%	-1.6%

Source: U.S. Federal Finance Housing Authority.

Figure 1
Home Price Indices
(1993 = 1.0)



Source: U.S. Federal Finance Housing Authority.

Property Tax Burdens

Studies that compare relative property tax burdens over time or across states often quantify the tax burden using one of two metrics: (1) on a per capita basis or (2) as a share of state personal income. Figures 2 and 3 present both measures for the U.S. (weighted average across all states), Michigan and Pennsylvania for 1992 to 2012. Property taxes include all levies by state and local units for operating or debt purposes.[23] The per capita measure uses real property taxes which excludes inflation. The exclusion of inflation is not necessary if property taxes are measured against state personal income because that measure also includes inflation, so the impact of inflation is effectively neutralized.

Figure 2 uses the real per capita measure (2012 dollars). Notable trends include:

- Proposal A caused a significant decline in the real per capita property tax level from $1,555 (1994) to $986 (1995), a 36.6 percent reduction. That level was lower than respective values for the U.S. and Pennsylvania.
- Since passage of Proposal A, Michigan real per capita property taxes increased most years through 2007. By 2007, the level surpassed the pre-Proposal A level.
- Due to the severe economic recession, the real per capita measure has declined rapidly, and is now roughly equal to Pennsylvania. The housing bubble had a smaller impact on real per capita levels for the U.S. and Pennsylvania because the recession was less severe and there is generally a longer time lag between reappraisals compared to Michigan.[24]

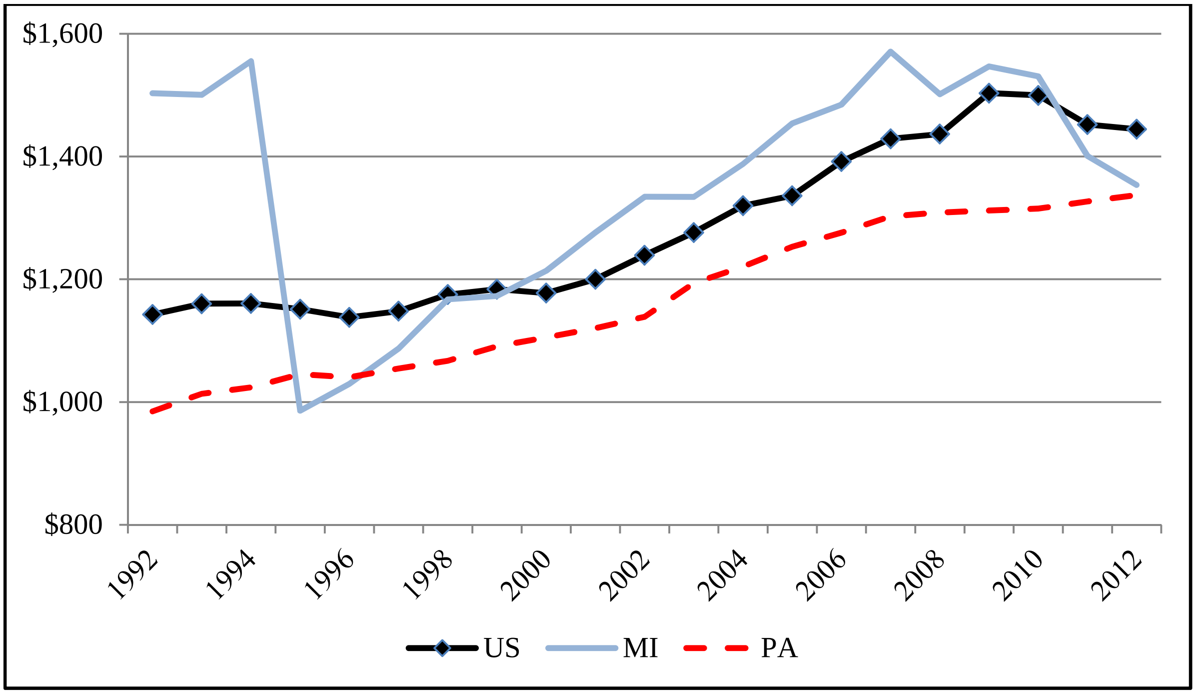
Figure 3 uses property taxes as a share of state personal income. Notable trends include:

- For Michigan, a similar dramatic reduction after passage of Proposal A.
- Although the Michigan measure immediately fell below the U.S. and Pennsylvania, the current burden measure remains higher than both, but still far below the pre-Proposal A level.
- The U.S. and Pennsylvania measures are relatively unchanged from 1992 to 2012.

[23] Property tax data are from the U.S. Census Bureau, see http://www.census.gov/govs/local/. Personal income data are from the U.S. Bureau of Economic Analysis, see http://www.bea.gov/regional/index.htm.

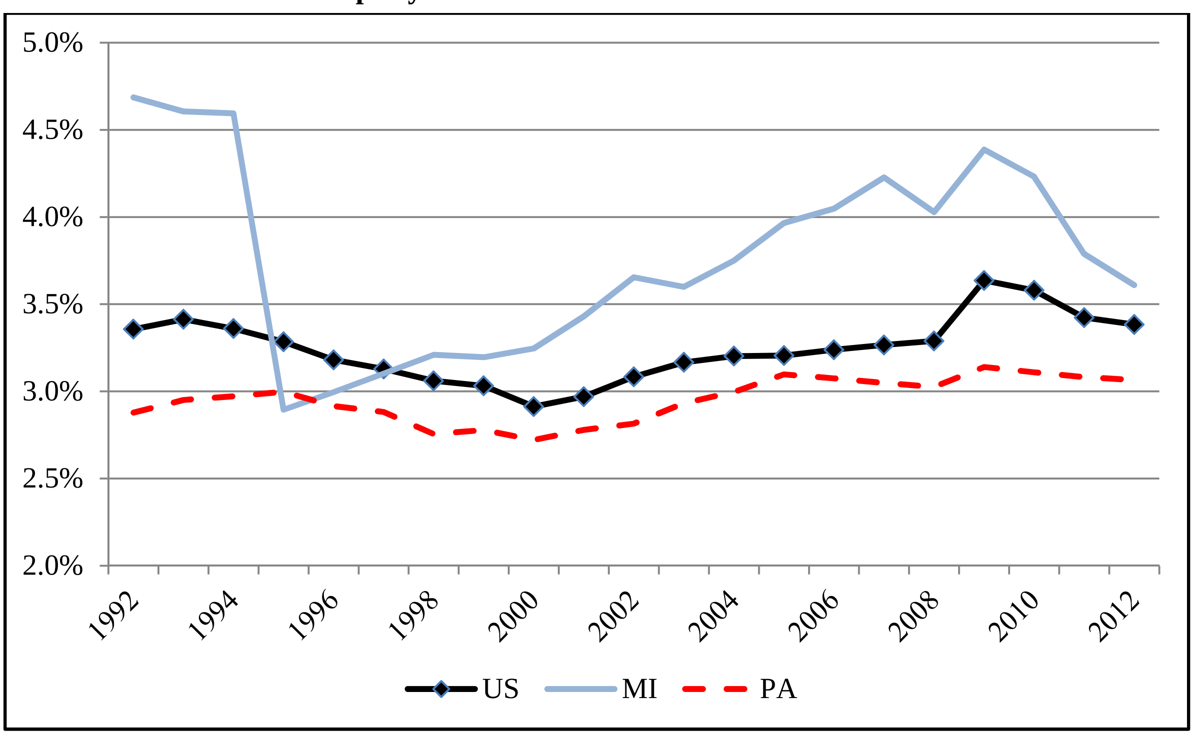
[24] In Michigan, property tax assessments are updated annually, although physical reappraisals occur less frequently. To update assessments, officials use 24-month sales studies to approximate the increase in home values. Recently, many Michigan assessors have been more inclined to use foreclosure sales as evidence of declining home values. In Pennsylvania, there is no standard timeframe for updating property tax assessments because each county determines the frequency of reassessments. While some counties update their assessments on a regular basis, others have not performed a countywide reassessment since the 1950s or 1960s.

Figure 2
Real Per Capita Property Taxes



Source: U.S. Census Bureau.

Figure 3
Property Taxes as a Share of Personal Income



Source: U.S. Census Bureau and U.S. Department of Commerce, Bureau of Economic Analysis.

The general increase in the property tax burden using the second metric is due to the fact that the Michigan (capped) property tax base has grown more quickly than Michigan personal income or the underlying economy. From 1994 to 2012, the Michigan property tax base increased by 80.2 percent, or 3.3 percent per annum. That growth rate has outpaced the average growth of Michigan personal income (3.0 percent per annum). In addition, average statewide millage rates have increased by 2.1 mills, largely due to millages for debt and building/site purposes.

It is important to note a caveat to these graphs. Proposal A implemented a new distinction between homestead and nonhomestead property, and Michigan homeowners received a much larger property tax cut than owners of nonhomestead property (e.g., businesses and vacation homes). If homestead property were tracked separately, then the patterns would likely reveal a more dramatic reduction in property tax burdens for homeowners following Proposal A. For example, a recent report by the Michigan Department of Treasury finds that the average statewide millage rate for homeowners fell from 56.6 mills in 1993 to 32.4 mills in 2008. By contrast, the average millage rate for nonhomestead property fell to only 51.1 mills.[25] However, the decline in homeowner property tax burdens was also partially offset by a large reduction in the Homestead Property Tax Credit and Renters Credit that residents claim on the Michigan personal income tax form. For FY 2002-03 (latest estimate available), the Michigan Department of Treasury estimates that the credit fell by $1.5 billion due to Proposal A. If those amounts were also included in the analysis, then the net reduction in homeowner property tax burdens would be reduced.

[25] See "The Michigan Real Property Tax Real and Personal 2008 Statistical Update" (September 2010, Exhibit 34) at http://www.michigan.gov/documents/treasury/2008_Stat_Update_PropTaxReport_Sept2010_333410_7.pdf.

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Summary

When Michigan voters approved Proposal A, the intention was to achieve four basic goals: (1) reduce property tax burdens, (2) reduce per pupil funding disparities, (3) limit annual increases in property tax assessments and (4) increase state control over local school district finances. Despite very unusual economic conditions, the data suggest that Proposal A has been largely successful in achieving those goals. After twenty years, relatively few changes have been made to this major tax and funding reform.

However, it is also likely that Proposal A had many unintended and unanticipated outcomes. As discussed in this analysis, those outcomes could include:

- Policymakers thought that revenues would at least keep pace with inflation, but since 2001, that has not occurred. (See Table 2.) In particular, sales tax revenues earmarked to the School Aid Fund (SAF) have been weak.
- Due to extreme funding pressures, the current weighted average statewide foundation allowance is considerably lower than the amount for FY 2008-09, both in nominal (6.8 percent lower) and real (11.8 percent) terms. (See Table 3.)
- The general reduction in pupils has created funding pressures because school districts do not have direct control over per pupil operating revenues. This has led some school districts to compete for students based on facility upgrades and other criteria.
- In order to fund upgrades, local school district debt has increased dramatically. (See Tables 4 and 5.)
- The increase in debt issuance and a stagnant economy have neutralized some of the reduction in property tax burdens since enactment of Proposal A. (See Figures 2 and 3.)
- For various years, it has been necessary to transfer additional monies from the General Fund or rainy day fund to allow lawmakers to achieve desired foundation allowance levels.
- Proposal A does not prohibit SAF spending for community colleges or colleges/universities. It also does not prohibit changes in law that reduce SAF revenues.
- In addition to the foundation allowance, the legislature also controls the expenses that comprise operational expenses. For example, Proposal A shifted responsibility for all school employee pension costs to local school districts. Previously, the state contributed funds to cover some portion of those costs.[26]

[26] In FY 1995-96, school districts paid 14.6 percent of employee wages for pension/retiree health care costs. That rate dropped to 10.8 percent in the late 1990s, but is now at 25.4 percent for employees hired prior to July 2010.

An impact that is more difficult to quantify is the effect that Proposal A has had on General Fund expenditures. In theory, the earmarking of revenues should segregate the Michigan General Fund from the SAF. However, annual appropriation decisions that involve those two funds are made simultaneously by policymakers, and there will be leakage from one fund to the other because lawmakers have discretion over per pupil funding levels. The recent diversion of revenues for higher education is an example of the leakage between those funds.