

I. EXECUTIVE SUMMARY

For years, Michigan residents have wanted property tax relief along with more equal educational funding across the state's local school districts. Michigan property taxes were above the national average. Funding inequities among school districts continued to grow plus an increasing number of millage elections were being defeated due to voter discontent with high property taxes. Frustration with these issues peaked in August 1993 when the Michigan Legislature repealed property taxes as the primary funding source for K-12 education.

In response to the elimination of property taxes for school funding, Governor Engler proposed a new funding approach to be placed on the ballot for voter approval. On March 15, 1994, Michigan voters approved Proposal A, which revamped how schools would be funded and also provided educational reforms. Proposal A promised a minimum per pupil foundation allowance, more equity among local school districts, lower property taxes, and more school accountability.

Different from other proposals to change school funding, voters were not able to keep the status quo if the proposal did not pass. Essentially, voters were asked to increase the sales tax rate (Proposal A) or increase the income tax rate if Proposal A failed (Statutory Plan). Going back to the old system was not an option. Proposal A also provided a new mix of other tax changes that would provide funding for Michigan schools. State taxes, instead of local property taxes, would now fund local school district operating costs.

Before Proposal A, Michigan's property tax burden was more than 33 percent above the national average with the sales tax 32 percent below the national average. Both are now near the national average.

All local school districts are provided a minimum foundation allowance per pupil which has lowered the spending gap between low and high spending school districts. For FY 2003, the minimum foundation allowance is \$6,700 per pupil. Before Proposal A, the top ten spending districts outspent the lowest ten spending school districts by almost a 3:1 ratio. Currently, this ratio between the top ten highest and lowest spending districts is less than a 2:1 ratio.

Publicly chartered schools and "schools of choice" were another part of the reforms enacted with Proposal A. Charter schools are considered public schools that are organized by teachers, parents, universities, etc., and chartered by a public entity. Schools of choice allow students to attend a public school in a district other than where the student resides.

Proposal A dramatically decreased the amount of property taxes paid by Michigan residents and limited future increases. Starting in calendar year 1995, property taxes have been levied on taxable value instead of state equalized value. Taxable value increases are constitutionally limited to 5 percent or the rate of inflation, whichever is less. When a property is sold, the tax base reverts to state equalized value and annual taxable values are then capped once again.

Property is now classified as homestead and nonhomestead. Homestead property is considered to be a Michigan resident's home. Business property, rental housing, and vacation homes are

considered to be nonhomestead property. Property that is not a homestead and not qualified agricultural property can be assessed up to an additional 18 mills for local school operating purposes.

Michigan residents and businesses have seen large decreases in the millage rates assessed on their property. In 1993, the average statewide millage rate for all property was 56.64 mills. In 2000, the statewide average homestead millage rate was 31.54 mills and the nonhomestead rate was 50.10 mills.

Local school debt millage has increased since Proposal A. The number of school districts participating and the amount of new bonds issued through Michigan's School Bond Loan Program have increased dramatically. Since 1994, the number of school districts participating has jumped from 42 to 130 districts, an increase of 210 percent. The total amount of qualified debt outstanding increased from \$4.1 billion in 1994 to \$11.1 billion in 2001.

II. INTRODUCTION

It has been nine years since August 1993, when Public Act 145 of 1993 became law, which effectively eliminated local property taxes as a source for K-12 and intermediate school district operating revenues. Public Act 145 of 1993 eliminated approximately \$7 billion in school operating funds and did not provide any alternative funding source.

In October 1993, Governor Engler delivered a message to a joint session of the Michigan Legislature based on a report entitled *Our Kids Deserve Better, New Schools for a New Century*. In this report, the Governor outlined his plan to reform Michigan's schools and the K-12 school finance system. The Governor's plan had four basic goals:

1. Reduce property taxes.

An immediate and substantial cut in property taxes to most property taxpayers.

2. Improve school funding equity.

A new system of school funding: the foundation grant system. Under the foundation grant system, the State would take responsibility for a greater share of school funding in an attempt to improve funding equity across school districts. School funding equity would be enhanced through a constitutionally-guaranteed minimum funding level per student.

3. Implement various reforms to improve the quality of education.

Reforms included allowing parents and children to choose among competing public schools, lengthening the school year and the creation of charter public schools. A student's foundation allowance would follow the student to his or her school of choice.

4. Redefine state and local government relations.

State law would be modified to limit the number of property tax millage elections and eliminate the tie between state aid and local tax effort.

On December 24, 1993, legislation was enacted to allow for distribution of state School Aid Fund (SAF) revenues through the new foundation grant funding system. However, it was still unknown how the necessary revenue would be raised. To determine the new funding source(s), the legislature presented Michigan voters with two options. The first option, known generally as Proposal A, replaced most property taxes levied for local school operating purposes with a two-percentage point increase in the sales tax rate. The second option, known generally as the Statutory Plan (which would take effect if Proposal A was rejected), replaced most property taxes levied for local school operating purposes with a 1.4 percentage point increase in the Michigan individual income tax rate. Both plans included numerous other tax modifications, the most significant being a new state education tax (SET) levied on property. (The details are provided later in this chapter.)