SCHOOL AID PRORATION EXPLAINED

by Kathryn Summers-Coty and Joe Carrasco, Fiscal Analysts

When the first four-year School Aid budget was enacted last summer, Public Act 297 of 2000 appropriated funding through fiscal year (FY) 2002-03 based on a revenue picture that was bright and virtually unprecedented in its growth. One year later, revenue growth has slowed dramatically, necessitating action by the Legislature to balance a projected FY 2001-02 deficit, or failing that, proration of School Aid payments by the Executive branch.

On June 13, 2001, the House began public deliberations on House Bill (H.B.) 4371. This bill is a "negative supplemental" designed to address a projected deficit in the School Aid Fund (SAF) of roughly $175 million at the end of FY 2001-02, and a further $388 million estimated SAF deficit at the end of FY 2002-03. On June 28, the House passed H.B. 4371, decreasing the projected deficit to $28 million at the end of FY 2002-03.

The bill then was sent to the Senate, which passed its version of H.B. 4371 on July 11, with a projected deficit at the end of FY 2002-03 of $54 million. The next day, H.B. 4371 was returned to the House, which adopted further amendments but then did not concur in the amended Senate version on final passage. Therefore, the bill was sent to a Conference Committee, where it awaits further action. The same day the bill was sent to conference, the Executive branch issued a proration notice for School Aid, as specified in the State School Aid Act.

According to language in Section 11(3) of the School Aid Act, if the amount appropriated in the Act exceeds the amount available from the School Aid Fund, then payments under each section funded by the SAF (except for certain obligations specifically exempted in Section 11(3) of the Act) must be prorated across the board on an equal percentage basis (MCL 388.1611). The Senate Fiscal Agency (SFA) interprets the Act to mean that in addition to the specific obligations exempted from proration, programs supported by the General Fund also are protected from proration.

On July 12, 2001, the Governor, State Budget Director, and State Treasurer issued a package of statements describing an estimated 5% proration of payments under all sections in the School Aid Act, except for the obligation sections mentioned above, which must be paid in full. Unless the Legislature adopts and the Governor signs a new K-12 budget balancing next year's budget, the proration will be effective October 1, 2001, and will affect the 2001-02 fiscal year only. This means that all programs in place for the current fiscal year will remain funded at their currently enacted levels. (Unlike the proration scenario, both the House and Senate versions of H.B. 4371 would affect several programs in the current year.) The first payment for FY 2001-02 is scheduled to be made on October 19, 2001.

The School Aid Act specifies that if a proration becomes necessary, payments under certain sections of the Act must be made in full first, with payments under the remaining sections prorated on an equal percentage basis. The sections under which payments must be made in full are: **Section 11f** (*Durant* cash payments); **Section 11g** (*Durant* debt service payments); **Section 22a** (Proposal A Obligation payments); **Section 31d** (School Lunch payments); **Section 51a(2)** (Intermediate School District Special Education Headlee payments); and **Section 51c** (Local School District Special Education Headlee payments).

As previously indicated, combining the May 2001 Consensus revenue estimates with the currently enacted appropriations for FY 2001-02 yields a projected SAF deficit of $175 million at the end of FY 2001-02. The

Executive branch estimated that a 5% proration[1] would erase this deficit. However, this estimate was based on prorating sections funded either by the SAF *or* by the General Fund. The Senate Fiscal Agency's interpretation of the School Aid Act, however, holds that sections funded by the General Fund are not subject to the proration. Therefore, a proration of 5.1% of payments under all sections funded by the SAF that are not exempted under Section 11(3) would be necessary to achieve a $175 million saving in FY 2001-02. Of course, either proration percentage could change based upon new consensus revenue estimates, or changes in projected expenditures out of next year's budget.

If proration occurs, individual districts will be affected differently, based on the funding "mix" of their foundation allowances and categorical payments received. A district whose foundation allowance consists primarily of State dollars will be more greatly affected than one whose foundation allowance relies heavily on local funding. This happens because the proration affects only the State funding of a school district, not the local funding. The foundation allowances of public school academies (PSAs) are entirely State funded, since they are not allowed to levy mills for school operating purposes. Therefore, PSA foundations will face larger reductions compared with per-pupil funding in local school districts. (The SFA website includes a table listing each district's currently enacted FY 2001-02 foundation allowance, equity payment if applicable, and estimated reductions due to proration.)

If proration occurs in October, and a new School Aid budget is not enacted in order to avoid continued proration throughout FY 2001-02, then the SFA estimates that there will be a $388 million deficit at the end of FY 2002-03. This estimate is based upon a comparison of enacted appropriations for FY 2002-03 and unofficial revenue estimates for the same fiscal year. This scenario would require an across-the-board projected proration of more than 11% to balance the FY 2002-03 budget, or would require the Legislature and Governor to enact a budget either appropriating additional dollars or cutting programs to eliminate the projected deficit.

There is a provision within Section 11(3) that allows the Legislature to enact additional appropriations to prevent a proration of School Aid. The additional amount necessary to fund the projected shortfall may come from the General Fund, Counter-Cyclical Budget and Economic Stabilization Fund, State School Aid Fund balance, or any other source approved by the Legislature. The Department of Treasury may not begin the proration of School Aid payments unless the Legislature fails to adopt the amount necessary to prevent the proration within the prescribed time period.

If the Legislature desires to avoid proration in the upcoming fiscal year, the chambers have until early October to adopt a bill providing sufficient revenues (either by appropriating additional dollars or by cutting already-enacted programs) to balance the fiscal year 2001-02 budget. If this does not happen and proration occurs beginning with the October 19, 2001 payment, the Legislature still could take action to restore funding after the proration has taken place. However, school districts will receive a prorated payment until such time as the Legislature restores the amounts necessary to prevent further proration. The Legislature also could restore sufficient funding to repay school districts an amount equal to the amount that was reduced from all payments due to proration.

For more detail on the House- and Senate-passed versions of H.B. 4371, or an analysis of proration on Statewide appropriations in the FY 2001-02 School Aid Act, please visit the SFA website at www.senate.state.mi.us/sfa/.

[1)] The gross appropriation (excluding Federal funds) for FY 2001-02 enacted under Public Act 297 of 2000 is roughly $11.38 billion; out of this, the total of the obligation payments that must be made first and in full as mentioned above (e.g., Sec. 22a, Sec. 51c) is an estimated $7.88 billion. Thus, the remaining appropriations of approximately $3.50 billion ($11.38 billion minus $7.88 billion) would be the amount that would need to be prorated. The result would be an across the board proration for the remaining sections of the School Aid Act of 5% ($175 million divided by $3.50 billion).