

Analyzing the Governor's FY2025 Budget Recommendations

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Robert Schneider, Senior Research Associate



- Work Experience
 - 2nd period with Citizens Research Council
 - State Budget Office
 - House Fiscal Agency
- Policy Background
 - State budget
 - Human Services
 - Corrections
 - Transportation
- Education
 - B.S. in Economics from Central Michigan University
 - M.A. in Economics from Michigan State University.

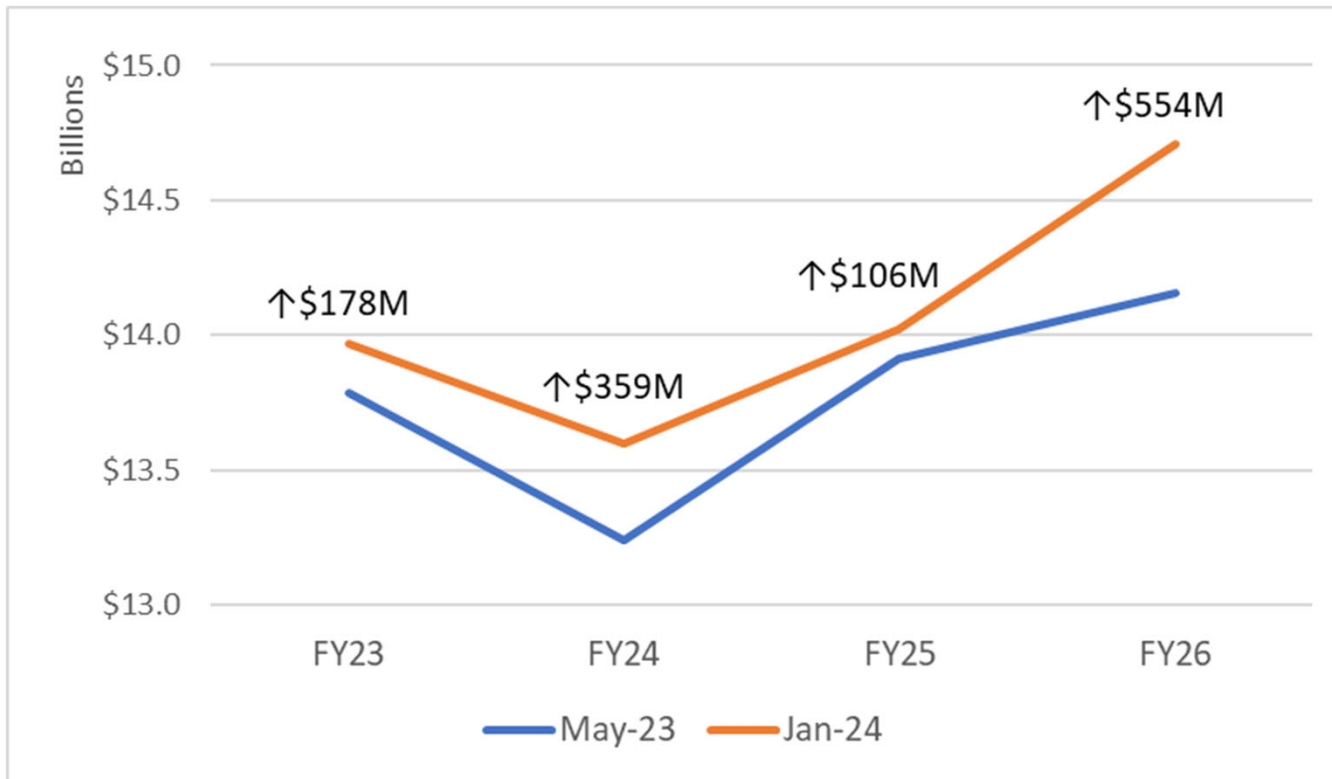
Craig Thiel, Research Director



- Work Experience
 - 2006 – present: Citizens Research Council
 - 1997 – 2006: House and Senate Fiscal
 - 1995 – 1997: Secretary of State
- Policy Background
 - State budget and taxation
 - K-12 education
 - Transportation
 - Inter-governmental relations
- Education
 - MPA, Wayne State University
 - BA, Kalamazoo College

The Big Picture: Revenue Situation Facing the Governor

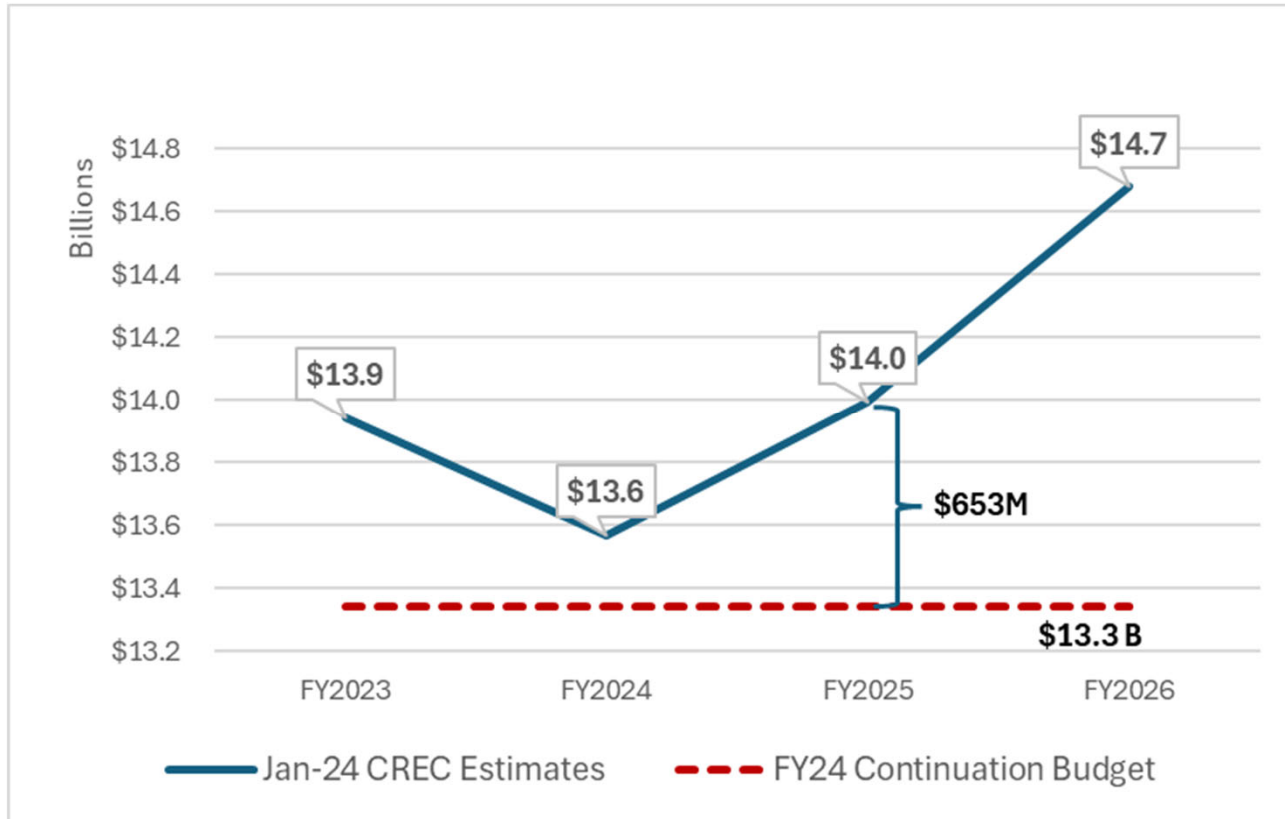
January Revenue Estimates – General Fund



Source: January 2024 CREC Final Summary.

- GF/GP revenue estimates up somewhat
 - FY23: up 1.3%
 - FY24: up 2.7%
 - FY25: up 0.6%
 - FY26: up 3.9%
- FY26 revenue includes \$550M coming back to GF/GP from Corporate Income Tax

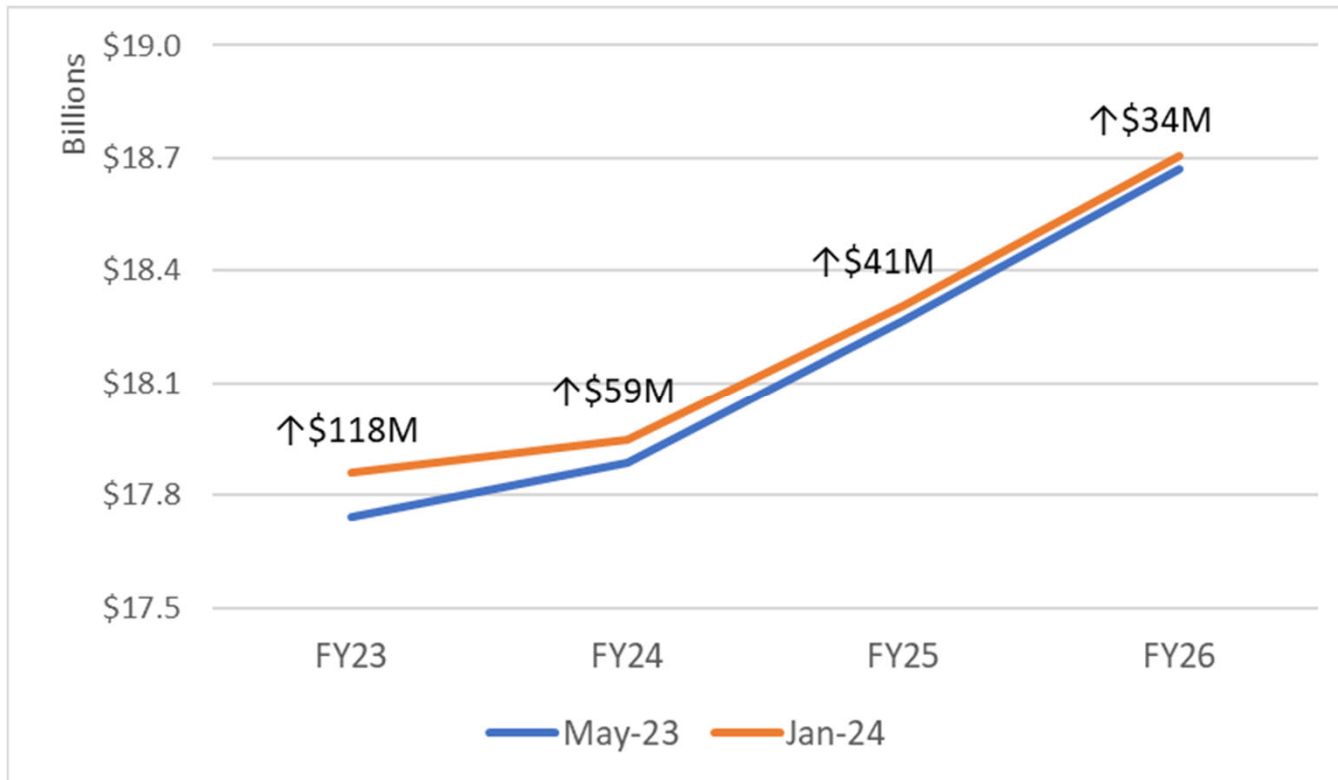
GF/GP Ongoing Surplus Around \$650M



- GF/GP revenue estimate for FY2025 exceeds FY2024 “baseline” by around \$650M
- Room for about 4.9% growth in ongoing GF/GP budget
- Last year, gap was \$2.5B

Source: Research Council calculations based on Senate Fiscal Agency balance sheet projections and Executive Budget Book..

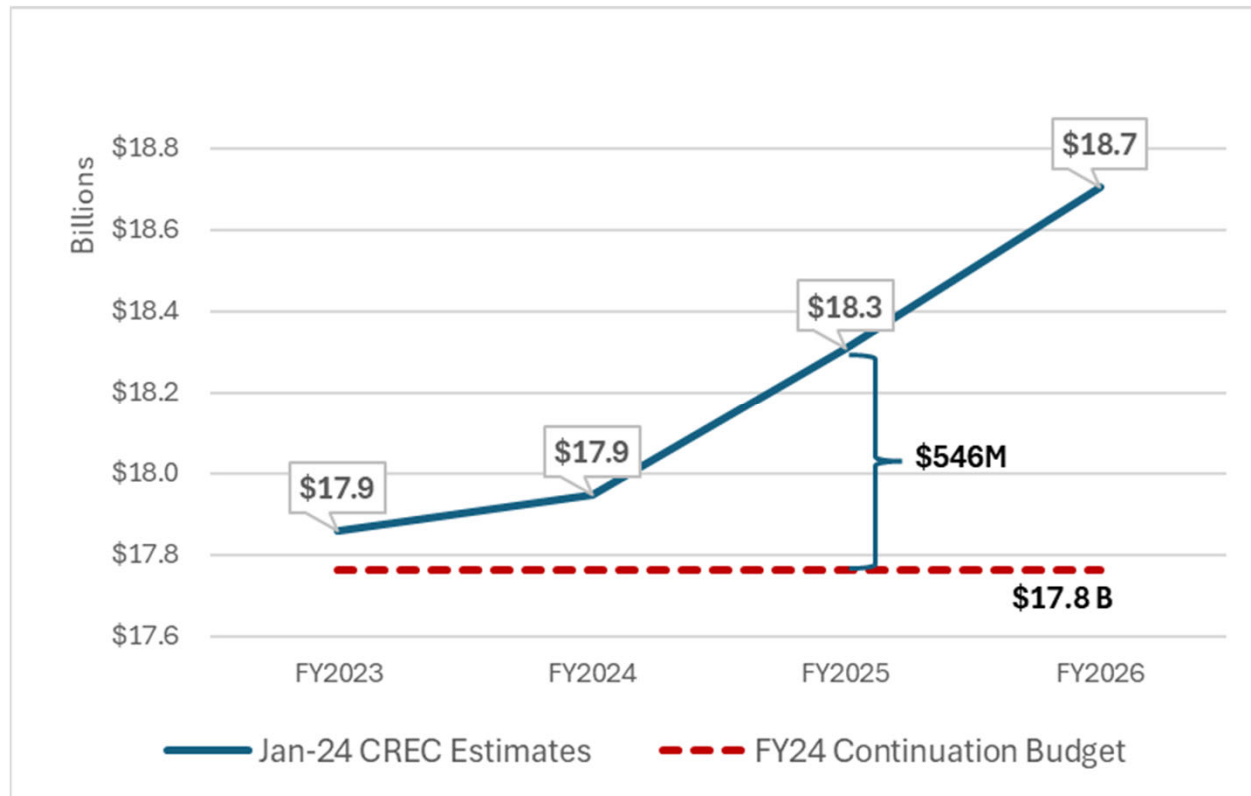
January Revenue Estimates – School Aid Fund



- Very modest upward adjustments in forecasted SAF revenue
- Up less than 1 percent in each year

Source: January 2024 CREC Final Summary.

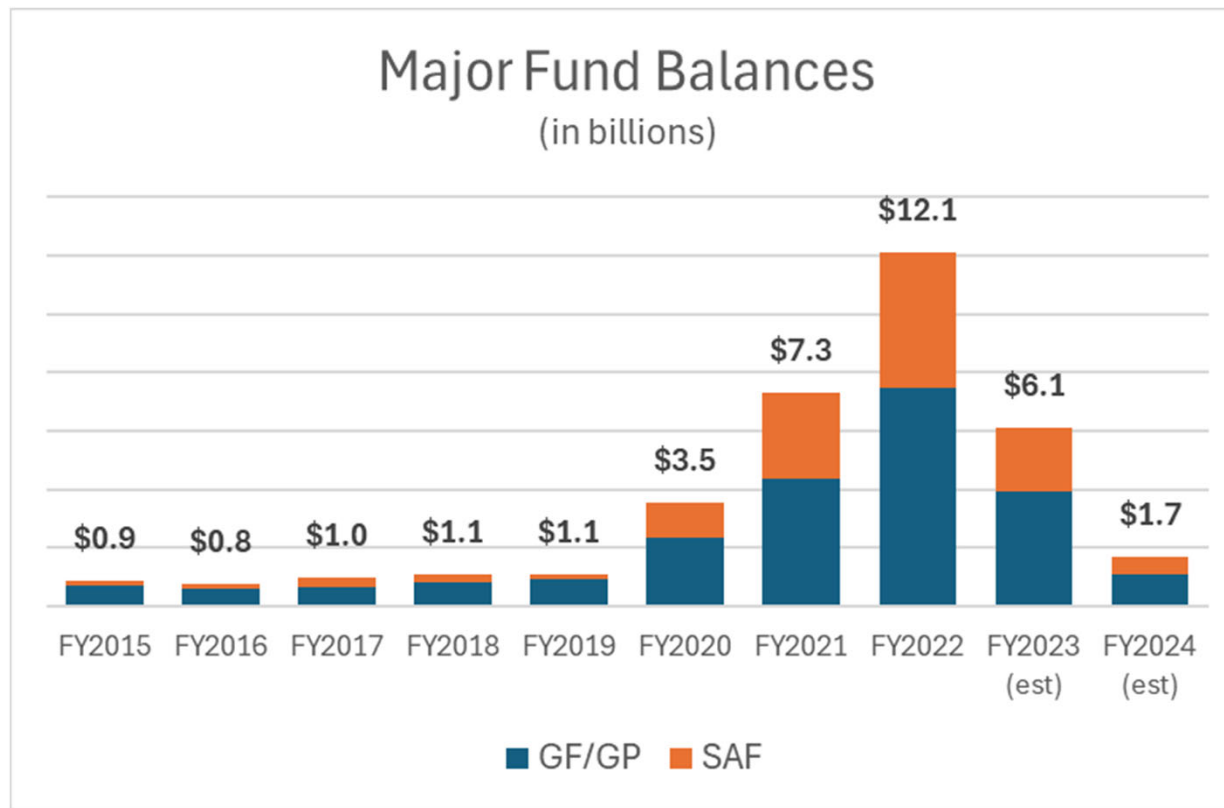
School Aid Fund: \$550M Ongoing Surplus



- SAF revenue estimate for FY24 exceeds baseline spending around \$550M
- Room for around 3% growth in ongoing SAF budget
- Last year, gap was \$1.3B

Source: Research Council calculations based on Senate Fiscal Agency balance sheet projections and Executive Budget Book..

State's "Money in the Bank" Has Fallen



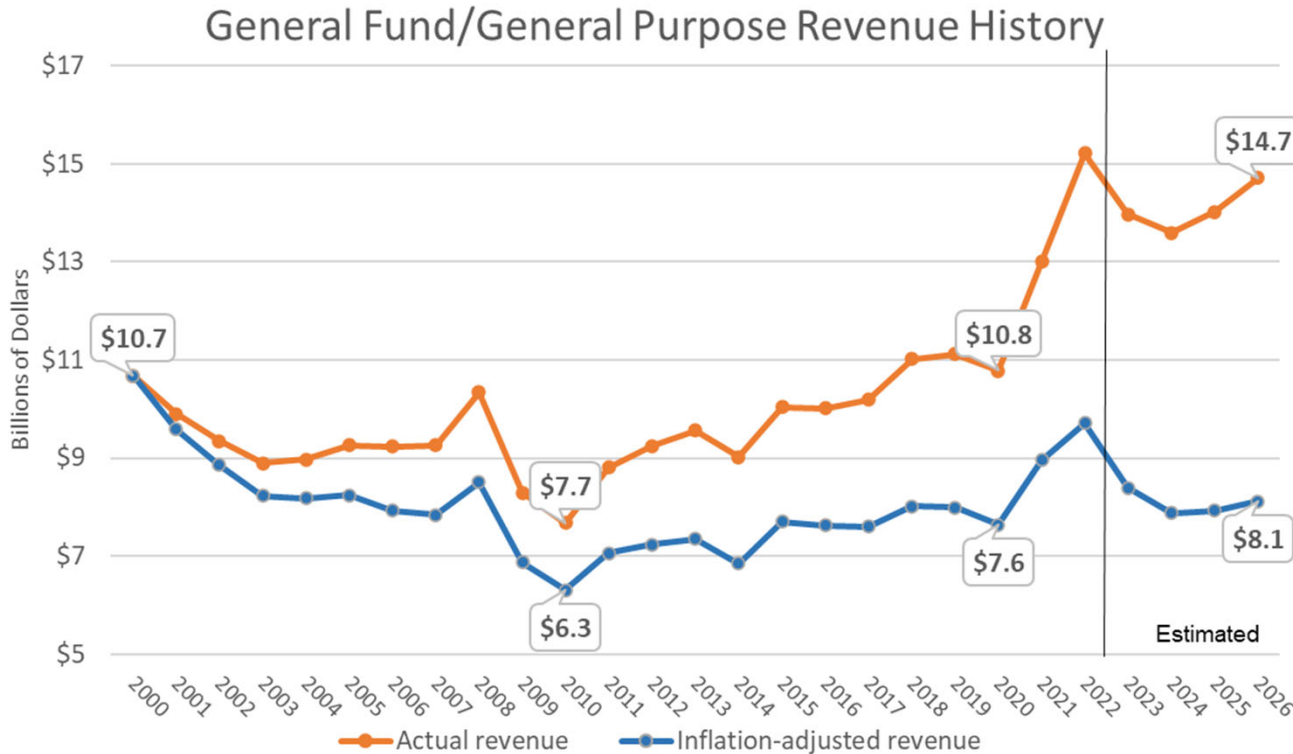
Both GF/GP and SAF projected year-end balances are down from the unprecedented levels realized over the previous four fiscal years.

FY24 Year-End Balance Estimates:

- GF/GP: \$1.1B
- SAF: \$564M

Source: State of Michigan Comprehensive Annual Financial Reports and House Fiscal Agency projections..

Perspective: Inflation-Adjusted GF/GP Still Down



After climbing out of a two-decade hole, GF/GP revenue is expected to grow by close to \$4B between FY2020 and FY2026

Still, adjusted for inflation, FY2026 revenue estimate is still down by 24% from FY2000

Source: Research Council calculations from Senate Fiscal Agency data. Inflation adjustment uses Detroit CPI-U data.

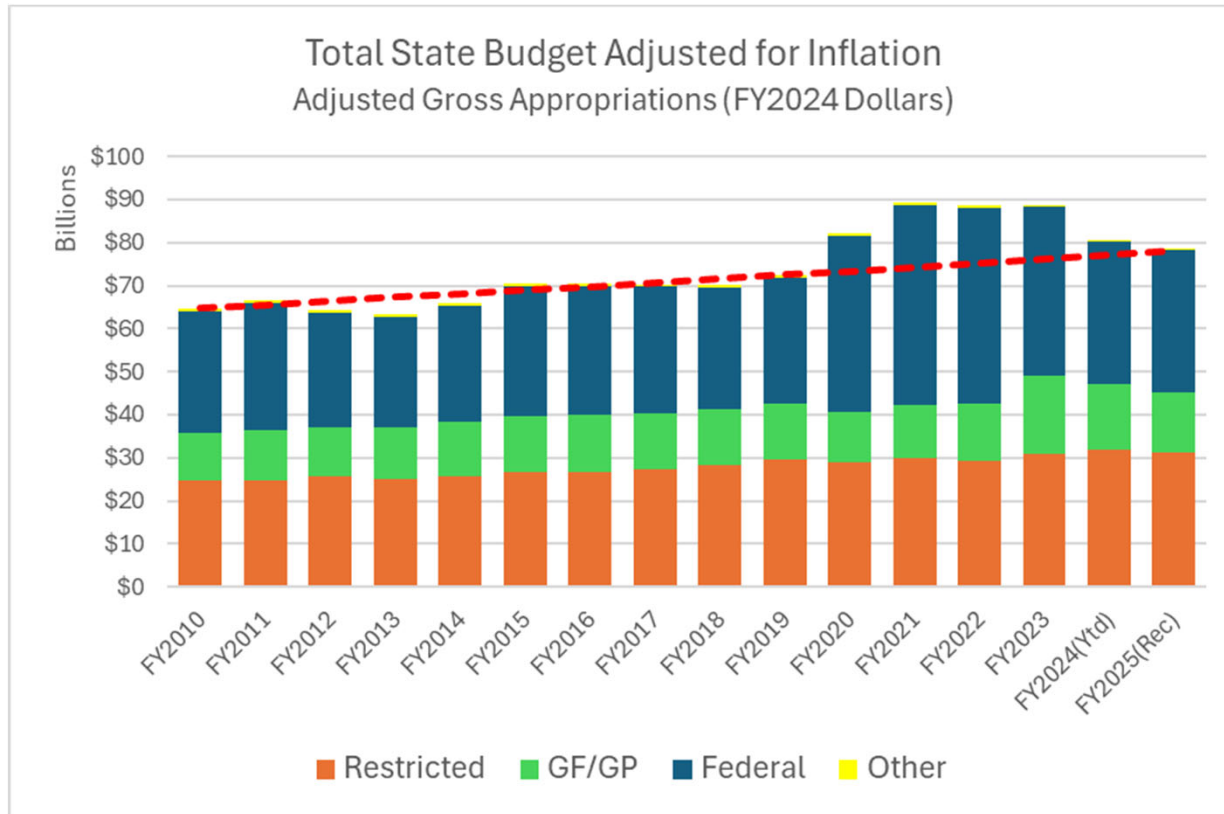
FY2025 Executive Budget

Highlights

Summary of Changes – GF/GP and SAF

	FY2024	FY2025	\$ Chg	% Chg
Total Appropriations	\$80.7B	\$80.7B	\$36M	0.1%
General Fund/General Purpose				
Ongoing Appropriations	\$12.8B	\$13.6B	\$885M	6.9%
One-Time/Supplementals	\$2.4B	\$669M	-\$1.8B	-72.5%
School Aid Fund				
Ongoing Appropriations	\$17.8B	\$18.2B	\$459M	2.6%
One-Time/Supplementals	\$1.6B	\$708M	-\$921M	-56.6%

Perspective on Recent Budget Growth



Source: Research Council analysis of Senate Fiscal Agency and House Fiscal Agency data

- In actual dollars, FY19 budget \$58B; by FY23 the budget grew to over \$85B
- Growth was largely driven by huge influx of federal revenue as well as one-time spending out of state fund balances
- Proposed FY25 budget returns to pre-COVID trend

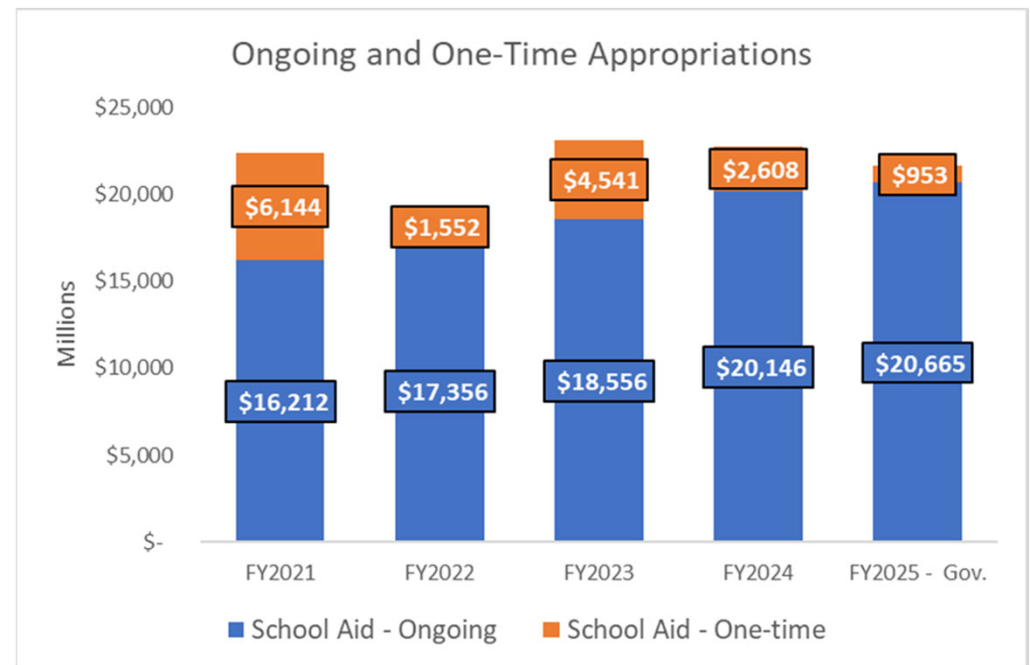
Education Budget Highlights

Background – Context for Executive Budget

- Student academic performance and well-being
 - Serious performance lags across many measures, especially for low-income students
 - Pandemic's profound negative impacts on K-12 learning and achievement
 - On top of academic struggles, student mental health challenges persist
- Return to “normal” revenue growth for School Aid Fund
- School Aid Fund surpluses (one-time and ongoing) largely exhausted
- End of one-time federal ESSER funding in December
 - Statewide: 7% of total General Fund spending (\$1,000 per student) in FY2023
 - Impact of funding cliff varies at individual district level
- FY2025 proposal builds on previous budget priorities
 - Design, develop, and implement a free, universal PreK-14 public education system
 - Expand access to free, publicly-funded PreK programs to all 4-year-olds (remove income eligibility)
 - Expand access to free community college to graduating high school students
 - Provide differentiated funding to meet unique needs of students – “at-risk”, special education, English learners

Big Picture: K-12 Appropriations

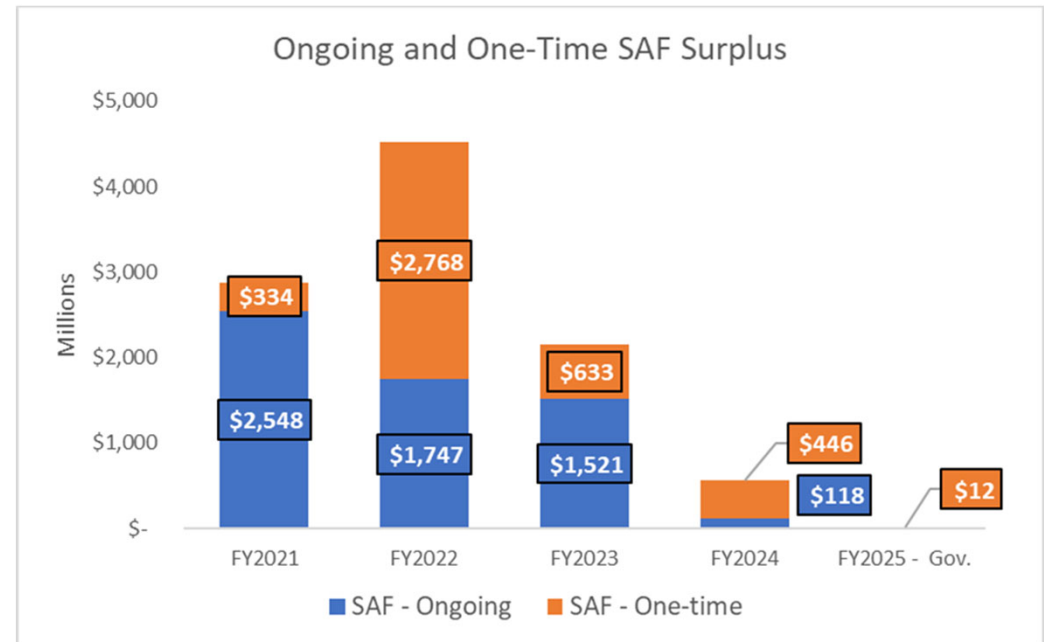
- Return to “normal” budget
 - Ongoing SAF revenue growth slows
 - Ongoing K-12 spending (all funds) up 3% in FY2025 compared to 9% in FY2024 (chart)
 - Total K-12 budget declines 4% in FY2025
- Spend down of SAF surplus
 - One-time appropriations of \$953M in FY2025
 - Down from \$4.5B in FY2023
 - Federal funds appropriated in FY2021, but spent in years since



Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

Big Picture: SAF Budget Surplus Spend Down

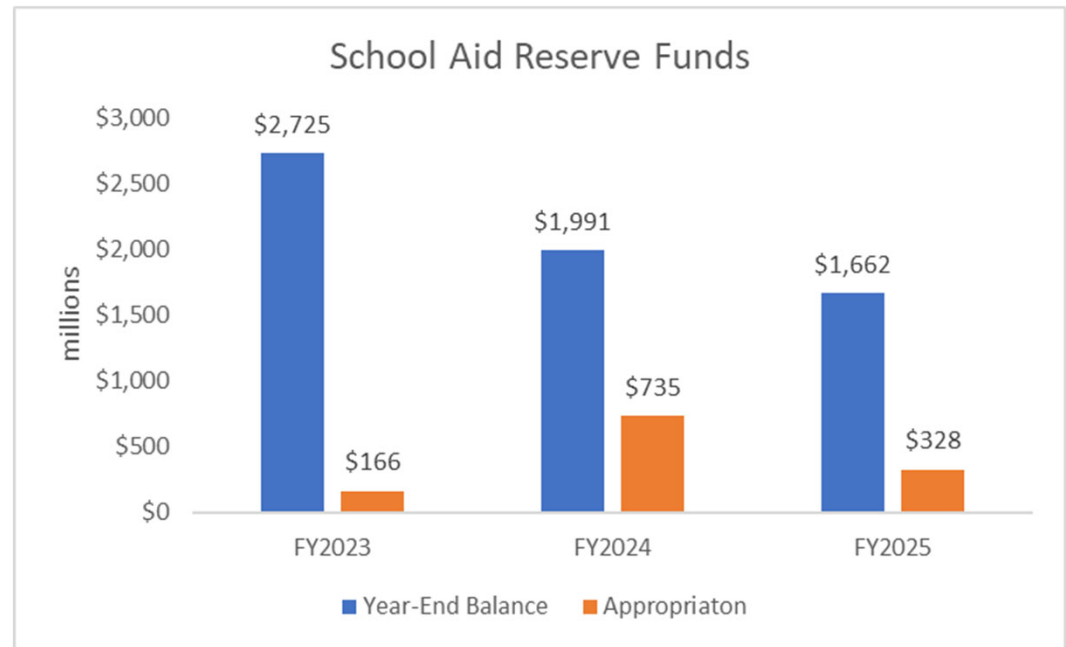
- FY2022 - \$4.5B combined surplus
 - Exhausted in FY2025 (chart)
- Ongoing surplus is function of better-than-expected revenue growth during pandemic
 - These funds later programmed into budget for ongoing items
- One-time resources fueled by various federal stimulus actions and year-end budget surplus



Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

Some Spending Covered by Reserve Funds

- Deposits of \$2.9B one-time SAF across various “reserve” funds in FY2022/FY2023
 - New “rainy day” fund (\$450M)
 - School infrastructure (\$475M)
 - Declining enrollment (\$314M)
- Reserve funds appropriated over several years
 - \$328M in FY2025
 - \$1.6B remaining FY2025 (chart)



Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

FY2025 Ongoing SAF Appropriations

K-12, community colleges and universities

- Overall, K-12 appropriations would see an inflationary increase
 - Reminder: year-over-year ongoing SAF revenue increase of \$370M
 - Below surface, budget includes several spending increases that hinge on change to pension funding law
 - Redirects \$632M current dedicated funding for retiree health liabilities to other budget priorities
- Higher education
 - 2.5% increase in operational funding for community colleges; 100% SAF
 - Current-year SAF amount for universities, plus \$94M GF to SAF shift

	School Aid Fund (millions)	
	K-12	Univ. and CC
FY24 Ongoing Approps.	\$ 16,665	\$ 948
Increases - Ongoing Funding	\$ 993	\$ 108
Decreases - Ongoing Funding	\$ (659)	\$ (44)
Baseline Adjustments	\$ 102	\$ (2)
FY25 Exec. Budget	\$ 17,101	\$ 1,011
<i>\$ Change</i>	\$ 437	\$ 63
<i>% Change</i>	2.6%	6.6%

Note: Table excludes appropriations identified as “one-time” for FY2025
 Source: Research Council calculations from Senate Fiscal Agency and House Fiscal Agency documents

School Employee Retirement System Proposal

- Two Components of Michigan Public School Employees Retirement System (MPERS)
 - Pension – \$35B unfunded liabilities (64% funded) as of 9/30/22
 - Scheduled to be fully funded by 2038
 - Retiree Health - \$89M unfunded liabilities (99% funded) as of 9/30/22
 - Projection: 100% funded by FY2025, therefore no amortization payment required
- Current MPERS “funding floor” provision added in PA 181 of 2018
 - Annual payments for unfunded liabilities (pension and retiree health) no less than prior year until ALL liabilities “fully paid”
 - As a result, actual contribution amounts for retiree health well-above actuarially-determined amounts since FY2020; pay-off unfunded liabilities much sooner
 - Proposal seeks state law change to reduce contributions for retiree health component above amount needed for 100% funding
 - This effectively “frees up” \$670M in FY2025 budget

MPERS Proposal - Budget Impacts

- Governor requesting statutory change to apply funding floor provision to **each separate component** of MPERS unfunded liability (pension and retiree health)
 - Reduces state’s portion of the unfunded liability payment by \$670M in FY2025 (table)
 - Redirects these SAF “savings” to other areas of the budget
- Required employer contributions for unfunded liabilities: **no statutory change requested**
 - State law caps employer contributions at 20.96% of payroll (pension and retiree health combined)
 - \$94M appropriation to reduce employer contribution to 20% of payroll
- Required employee 3% contribution for retiree health: **no change**

Summary of Change (in millions)								
	Pension UAAL Contribution	OPEB UAAL Contribution	Total UAAL Contribution	Employer Payroll	Capped Employer Share	State Share	Sec. 147c (K-12 and Libraries)	Sec. 201(5) (Community Colleges)
FY25, <u>without</u> statutory change	\$3,273.2	\$679.8	\$3,953.0	\$10,410.9	\$2,182.1	\$1,770.9	\$1,671.1	\$99.8
FY25 Executive Budget	\$3,273.2	\$10.4	\$3,283.6	\$10,410.9	\$2,182.1	\$1,101.5	\$1,039.4	\$62.1
Difference	\$0.0	\$ (669.4)	\$ (669.4)	\$0.0	\$0.0	\$ (669.4)	\$ (631.7)	\$ (37.7)

Source: FY2025 Executive Budget Recommendation

K-12 Budget Highlights

Base funding

- **Foundation allowance** – per-pupil grant funds general operations
 - \$241 increase (2.5%) to \$9,849 per-pupil
 - For FY2025, cyber schools would receive 80% of base foundation (\$7,879); these 16 schools did not an increase in FY2024 (\$9,150)
- **Declining student enrollment**
 - Estimated 0.4% decline in FY2025 and 0.5% decline in FY2026
 - Experiences vary considerably across 836 local districts/charter schools
 - Fewer students = fewer foundation dollars
 - \$71M for enrollment stability payments (same as FY2024)
 - Additional foundation allowance based on 50% of year-over-year student decline

K-12 Budget Highlights

Student-specific funding elements

- **Students “at-risk” of academic failure**
 - 2.5% increase to “at-risk” formula allocation – total \$976M (up from \$525M in FY2022)
 - Opportunity Index (poverty concentration) used to allocate funds; districts serving the neediest students receive larger per-student allotments
 - Target per-student funding weight - 35% of foundation allowance (currently prorated)
- **Special education students**
 - Full-funding of special education student foundation allowance PLUS required Headlee percentages
 - *New* - \$124M categorical grant to account for special education costs not currently covered by dedicated revenues (replaces current \$74M ISD millage equalization)

K-12 Budget Highlights

Student-specific funding elements

- **English language learners (ELL)/isolated districts**
 - Increases ELL student funding weights by 7.5% (up to \$1,097 per student)
 - Increases funding for isolated districts by 7.5%
- **High poverty students**
 - *New* - \$90M competitive grant program to address academic, social-emotional, physical needs of children receiving food stamps/cash assistance
 - Estimated 375,000 children qualify for food stamps statewide
 - These students currently qualify for per-pupil “at-risk” payments, but new funding will not be distributed on a per-pupil basis

Universal PreK Proposal – Budget Impacts

- Goal – 75% of Michigan 4-year-olds enrolled in publicly-funded preschool by 2027
 - Currently, 40% are enrolled across various programs (Great Start, Head Start)
 - Michigan will need to enroll additional 40K children in publicly-funded preschool to reach 75% goal
 - Estimated capacity of existing public programs - additional 6,800 children
- FY2025 funding items – expand access AND capacity for Great Start Readiness Program (GSRP)
 - Removes current income criteria for GSRP eligibility, but maintains requirement for programs to prioritize low-income student enrollment
 - \$64M for additional 6,800 GSRP slots within existing providers
 - \$43M to increase full-day per-child allocation from \$9,608 to \$10,342
 - \$35M (one-time) for preschool start-up grants to expand capacity

K-12 Budget Highlights – One-Time Funding

80% of FY2025 one-time appropriations previously funded

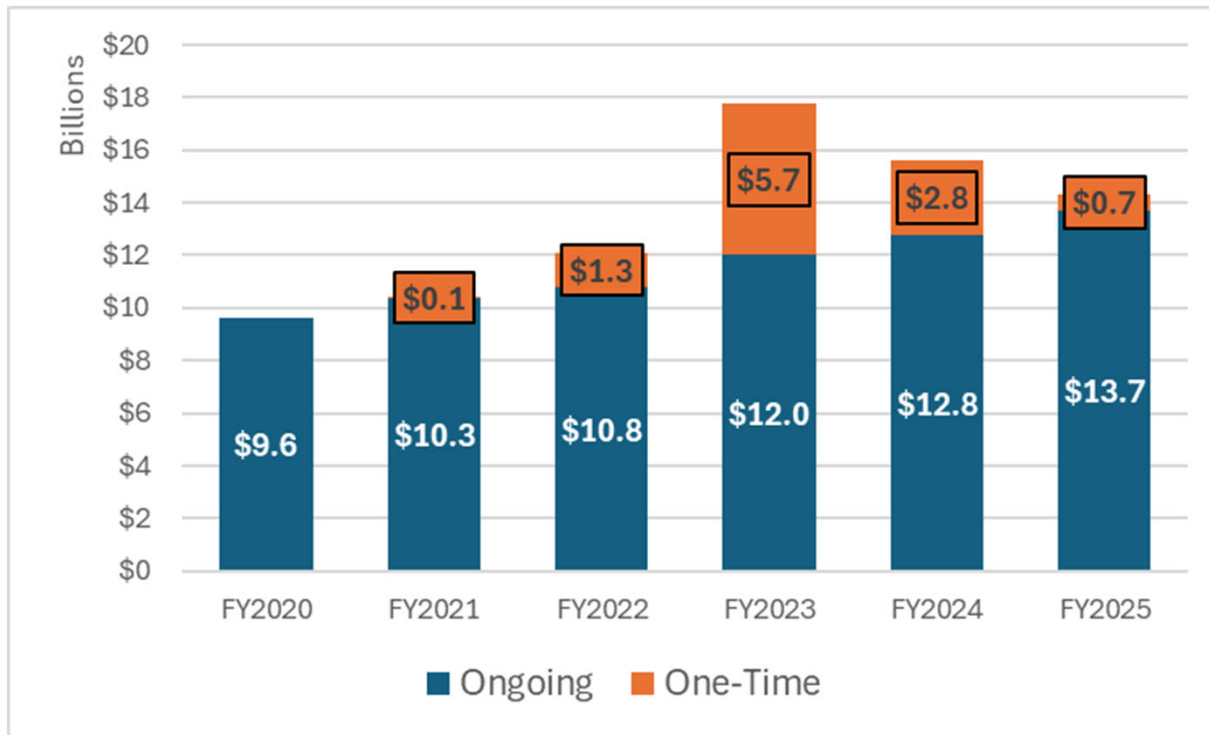
One-Time Funding	Total	Previous
Literacy supports – grants to improve literacy instructional practices	\$155M	No
MI Kids Back on Track – tutoring grants to address unfinished learning	\$150M	Yes
Mental Health – per-pupil payments for student mental health and safety	\$150M	Yes
Grow-Your-Own – grants to encourage existing school support staff to pursue initial teacher certification	\$50M	Yes
GSRP Start-Up Grants – expand capacity of PreK service providers	\$35M	Yes
FAFSA Completion – grants to increase financial aid application completion	\$40M	Yes
TOTAL – one-time appropriations	\$953M	\$762M

Big Picture Takeaways for K-12 Schools

- FY2025 proposal sets new base K-12 budget going forward now that previous budget surplus has been exhausted
 - 2.5% growth of foundation allowance and other base funding items (e.g., at-risk, special education)
- Key component – pension “funding floor” law change
 - Change frees up \$632M SAF on full-year basis for other K-12 items
 - Used to fund increases for existing programs, fund new programs, and convert some one-time items into ongoing appropriations
 - Without immediate effect, law change would generate one-half of savings

General Budget Highlights

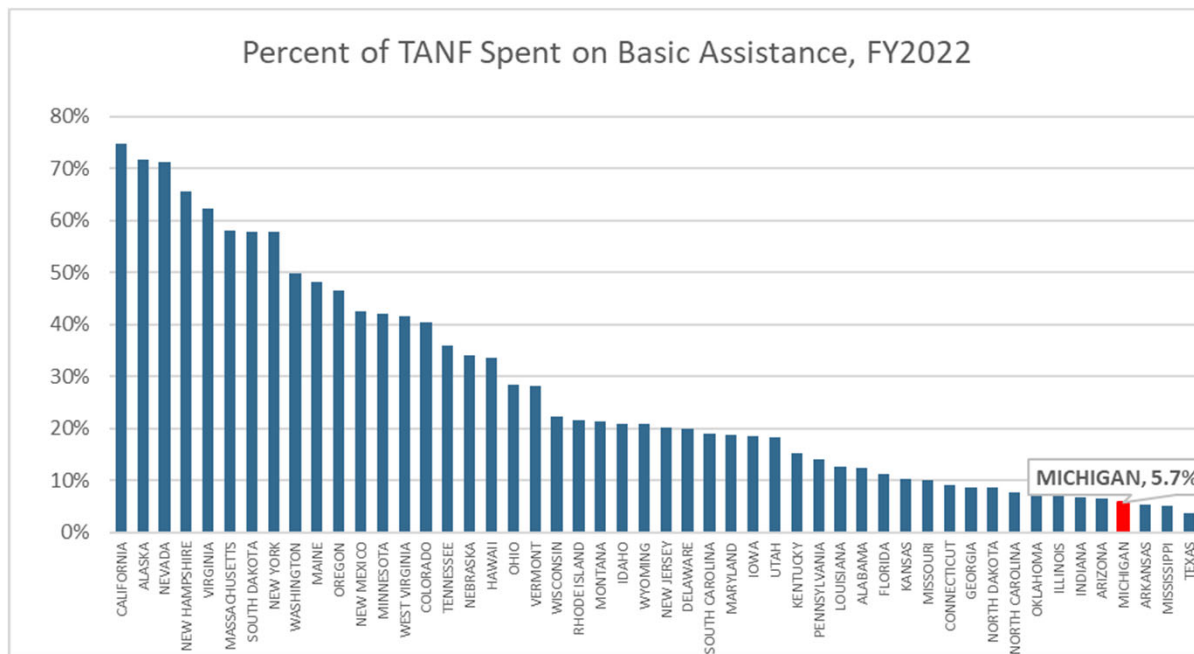
GF/GP Budget: “One-Time” Funding



- As with the overall budget, Governor’s GF/GP recommendation is marked a shift in appropriations from one-time to ongoing needs
- FY24 GF/GP Budget
 - \$15.6B total
 - \$12.8B ongoing
 - \$2.8B one-time
- FY25 GF/GP Proposed
 - \$14.3B total
 - \$13.7B ongoing
 - \$669M one-time

Source: House Fiscal Agency analyses of enacted budgets and Executive Budget book detail.

TANF Dollars Redirected to Assistance Programs

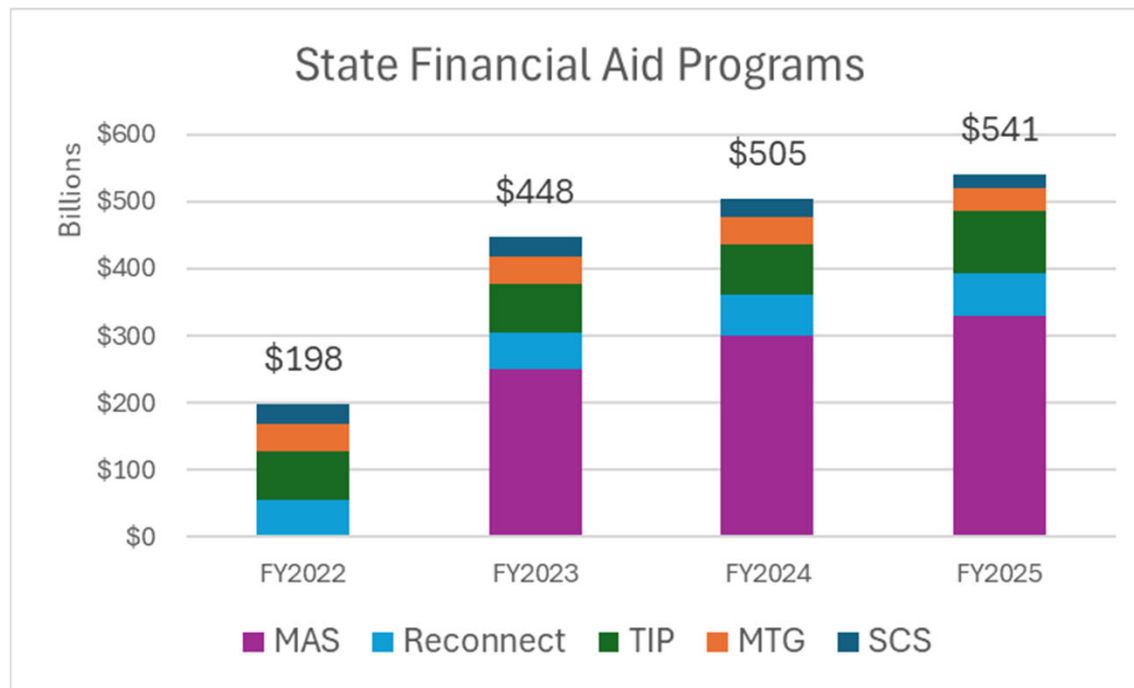


Source: U.S. Health and Human Services TANF expenditure data for FY2022

FY2022 U.S. Average = 39.8%

- Budget proposes to replace \$167.8M in federal Temporary Assistance for Needy Families (TANF) funding for college scholarships and DHHS administration with GF/GP
- TANF is redirected to more traditional social welfare uses:
 - \$64M for child care enhancements
 - \$35M to increase cash assistance payments to low-income families by 35%
 - \$10M to support \$100 monthly increase in assistance for young children under six
 - \$30M to increase emergency crisis assistance
 - \$24M for a Prenatal and Infant Support Program

Increased Support for Financial Aid Programs



Source: House Fiscal Agency analyses of enacted budgets and Executive Budget book detail.

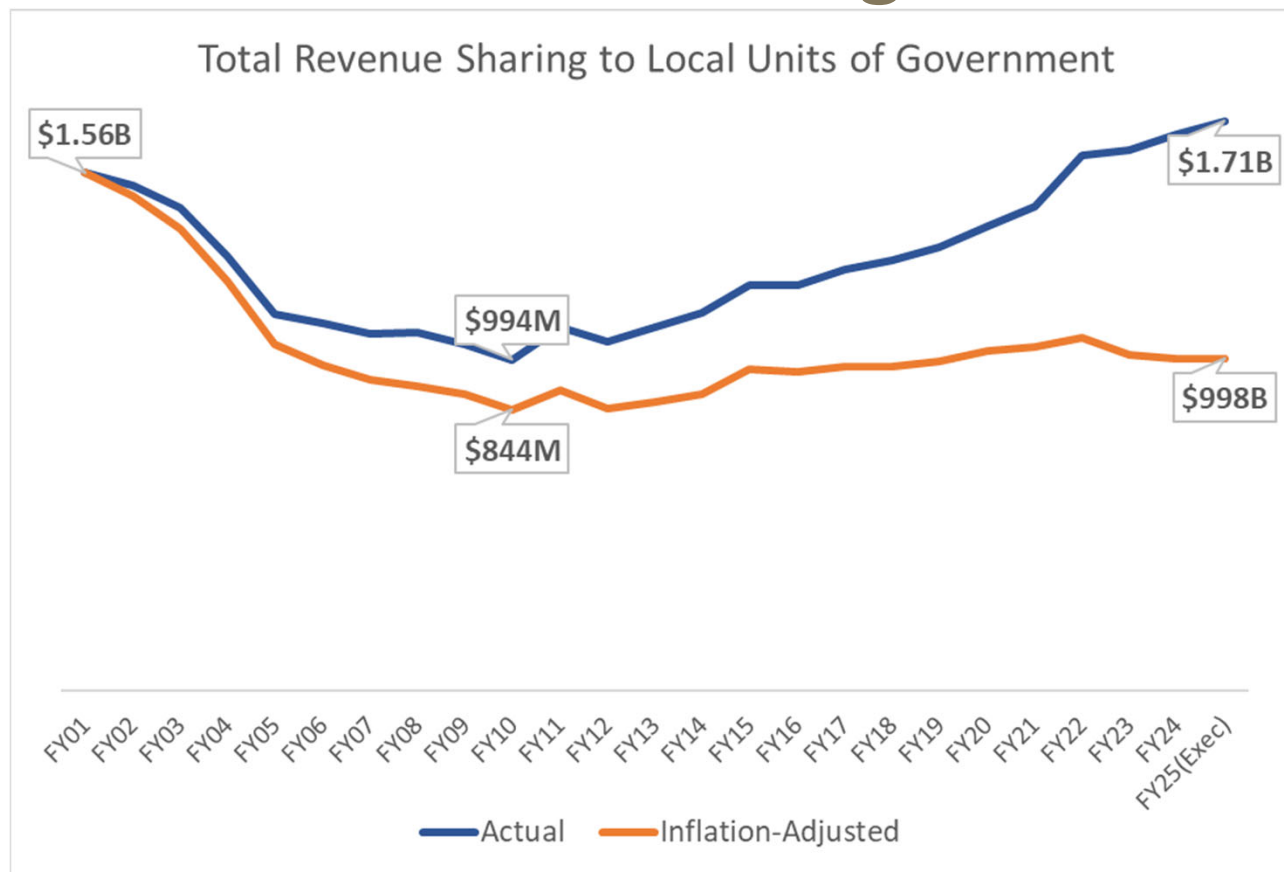
\$30M increase for Michigan Achievement Scholarships

- Community College Guarantee would provide full coverage for tuition for any future MI high school graduate
- Plus \$1,000 for income-eligible students for other costs (e.g. housing)

\$20M increase for Tuition Incentive Program for Medicaid-eligible students

On the other end, proposal begins phase out of State Competitive Scholarships and Michigan Tuition Grants

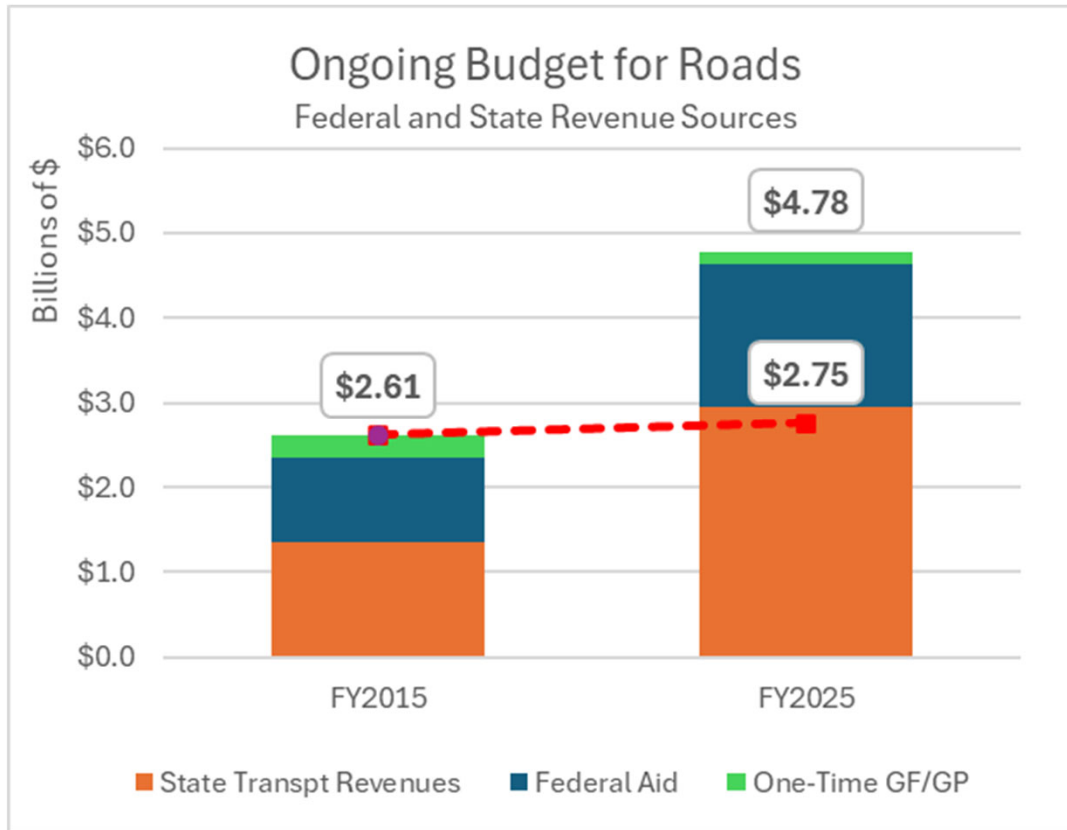
Local Revenue Sharing



Statutory (discretionary) revenue sharing:

- 5% ongoing increase for all local units of government (\$27.5M)
- One-time increase equivalent to 5% growth (\$27.5)
 - 2% for public safety
 - 3% local fiscal recovery fund incentive

What About the Roads?



- Governor's Budget includes over \$4.7B for road construction and maintenance projects
 - That includes \$150 million in one-time funding to support federal aid matching requirements and local bridge and culvert projects
- Chart examines changes in appropriations for road projects over the last decade
 - Total funding has increased by 83% due to 2015 road funding reforms and increased federal support
 - However, highway construction inflation has eaten away most of this increase
 - Final \$700M of Governor's \$3.5B bonding plan is due for release

Source: Research Council analysis of FY2015 enacted budget and FY2025 Executive recommendation. Dotted red line adjusts spending for road construction inflation as measured by National Highway Construction Cost index.

Tax Policy Proposals

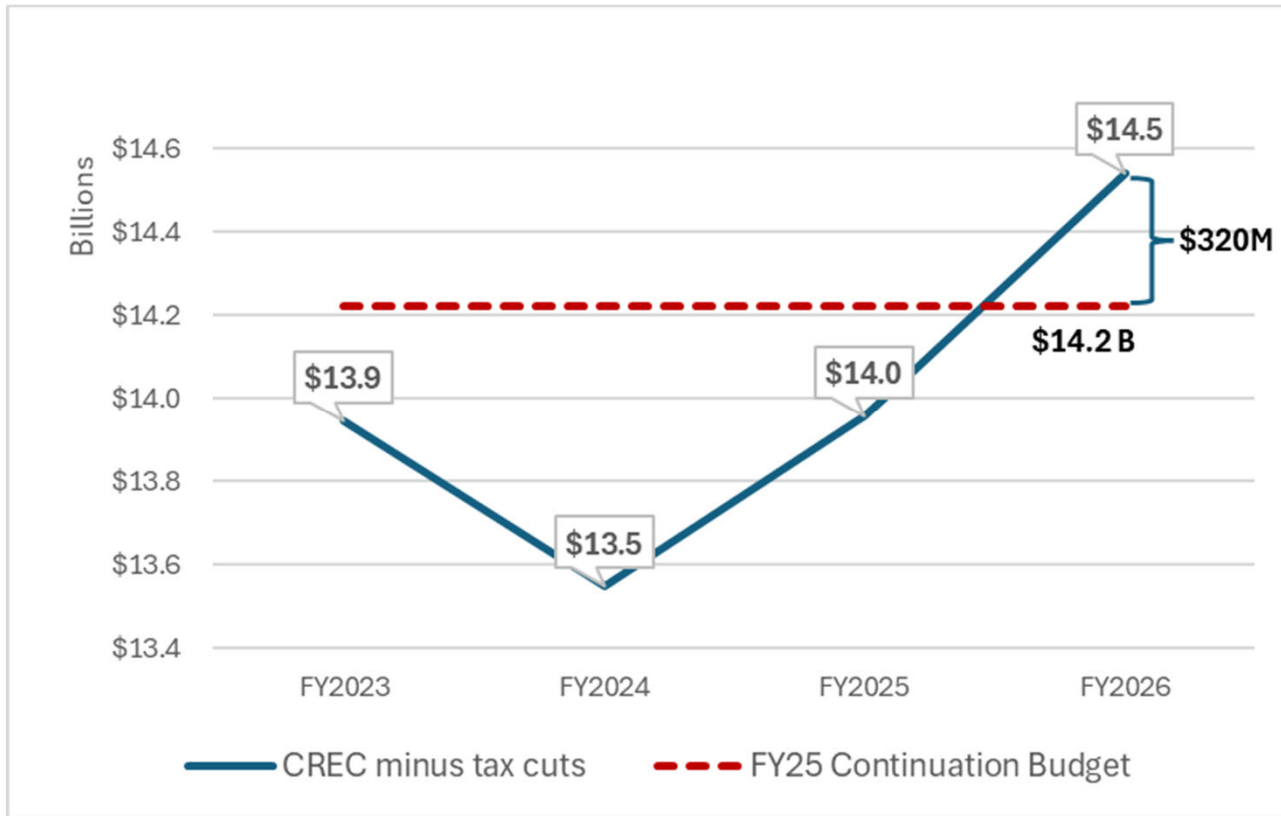
- Research and Development Tax Credit (\$100M): tax credit for companies engaged in qualified research and development efforts
- Caregivers Tax Credit: credit of up to \$5,000 for caregiving expenses on behalf of aging or sick relatives

GF/GP Revenue Foregone	FY2024	FY2025	FY2026
R&D Tax Credit			\$100M
Caregivers Tax Credit	\$22.5M	\$37.5M	\$37.5M
Total Revenue Loss	\$22.5M	\$37.5M	\$137.5M

Long-Term Budget Outlook

Michigan Budget Looks “Normal” Again

GF/GP: Room for Only Inflationary Growth

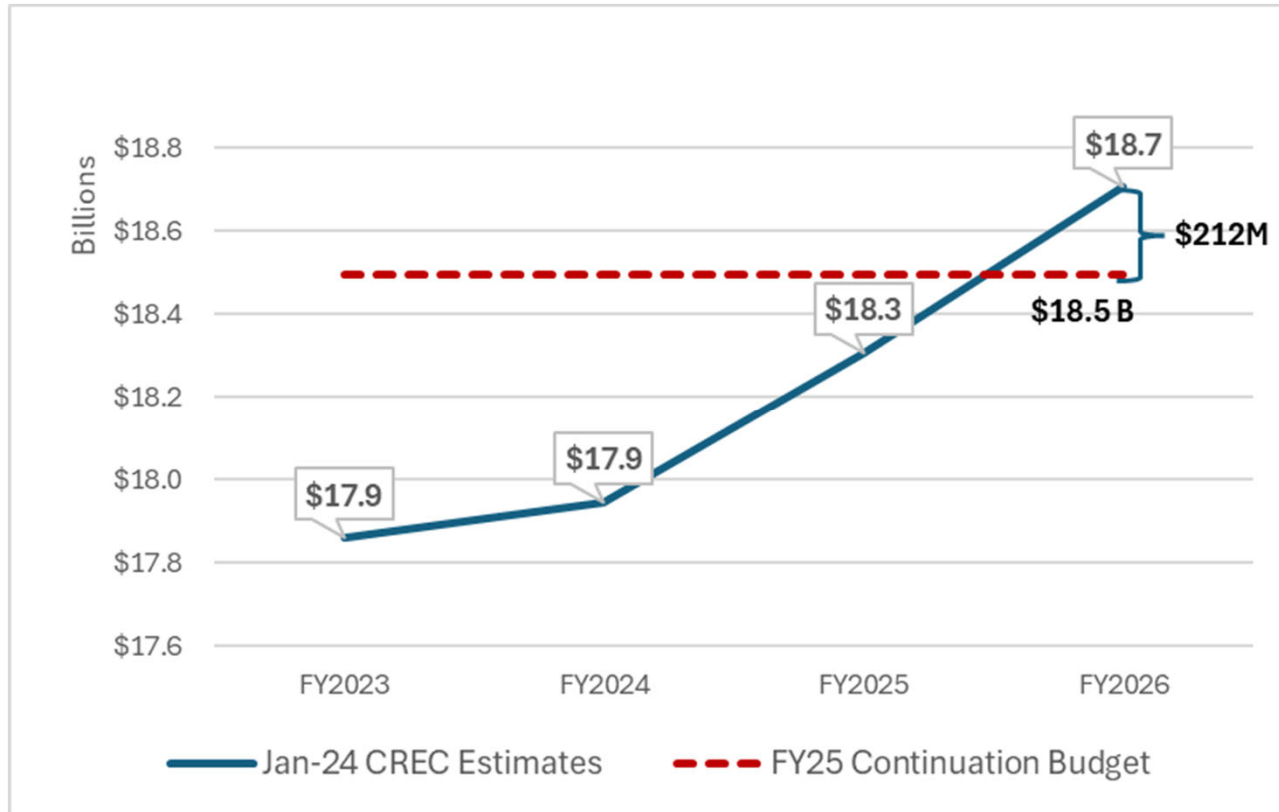


Room for only 2.3 percent GF/GP ongoing budget growth in FY26

GF/GP fund balance would largely disappear by the end of FY25

Source: Research Council calculations Senate Fiscal Agency balance sheet projections and Executive Budget Book..

SAF: Only Room for 1% Growth in FY26



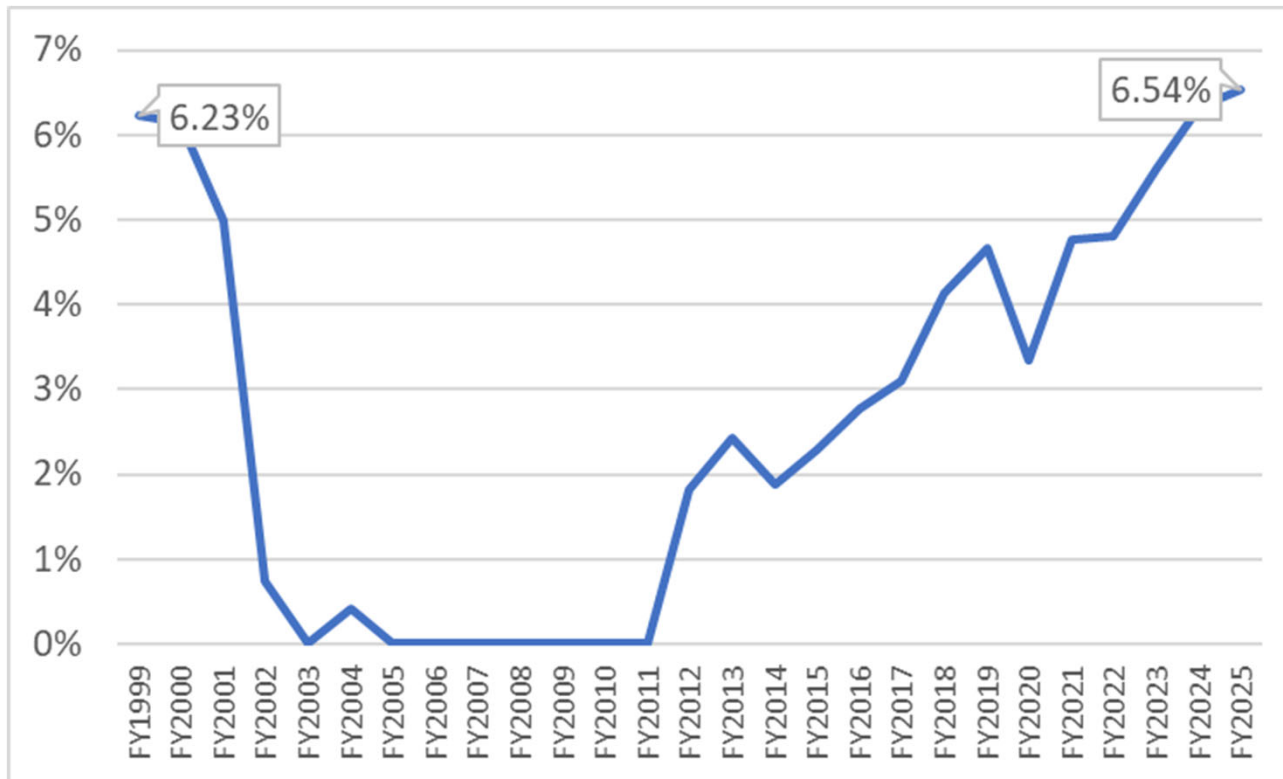
Room for very modest budget growth in FY26 of around \$212M (just over 1 percent)

SAF fund balances would be largely eliminated by end of FY25

Source: Research Council calculations Senate Fiscal Agency balance sheet projections and Executive Budget Book..

Another \$100M Increase in Rainy Day Reserves

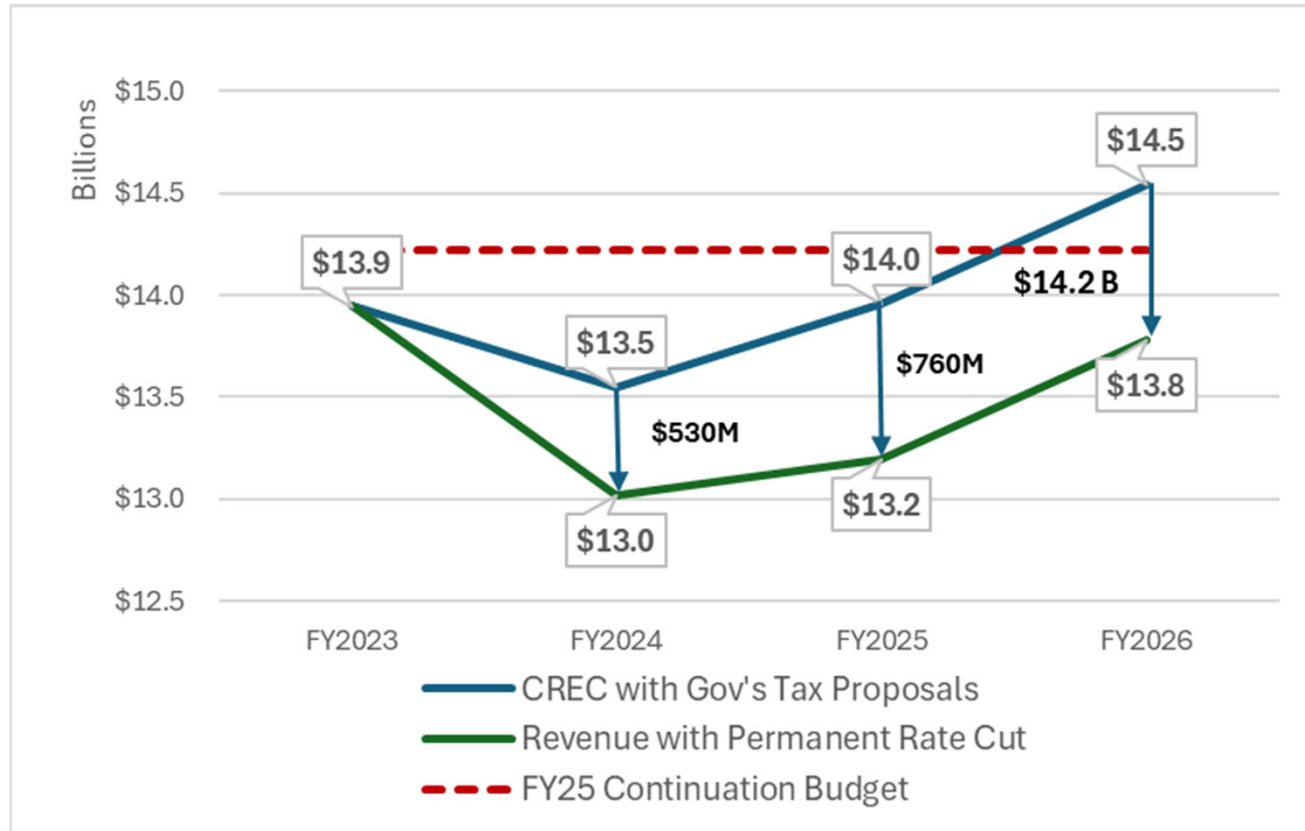
Budget Stabilization Fund as a Percent of Total GF/GP and SAF Revenue



Budget Stabilization Fund would grow by \$100 million in FY25, bringing balance to over \$2.2B by the end of the fiscal year

Reserves would equate to over 6.5% of combined GF/GP and SAF revenue, exceeding previous peak in FY99

What About the Income Tax Rate?



- If courts rule income tax rate cut should be permanent, FY24 GF/GP revenue falls \$530M, and revenue falls by \$760M annually thereafter
- \$1.3B budget hole across both FY24 and FY25 would immediately necessitate major budget revisions

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