

R60H
Maryland Prepaid College Trust

Operating Budget Data

(\$ in Thousands)

	FY 02	FY 03	FY 04	FY 03 - 04	FY 03 - 04
	<u>Actual</u>	<u>Approp.</u>	<u>Allowance</u>	<u>Change</u>	<u>% Change</u>
Nonbudgeted Fund	\$1,668	\$1,771	\$1,710	-\$61	-3.4%
Total Funds	\$1,668	\$1,771	\$1,710	-\$61	-3.4%

- The fiscal 2004 allowance in the Governor's budget book is for \$24,000 more than the trust expects to generate in revenues. This chart reflects the actual funds the trust expects to have in fiscal 2004.

Personnel Data

	FY 02	FY 03	FY 04	Change
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>
Regular Positions	6.50	9.50	9.50	0.00
Contractual FTEs	0.50	1.00	1.00	0.00
Total Personnel	7.00	10.50	10.50	0.00

Vacancy Data: Regular Positions

Budgeted Turnover: FY 04	0.00	0.00%
Positions Vacant as of 12/31/02	0.00	0.00%

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Fiscal 2002 Enrollment Period Second Best Since the Launch of the Prepaid Trust: 4,082 new enrollments in the 2001-2002 enrollment period brought the trust's total enrollment to more than 14,400 families, with nearly 300 students already using their tuition benefits.

Later Elementary and Middle School Enrollees Largest New Enrollment Group: Continuing a trend from prior years, larger numbers of students are enrolled in the Prepaid College Trust when they are in their later elementary and middle school years. The average age of enrollees is about eight years old.

Issues

Trust Reports \$29.8 Million Deficit for Fiscal 2002: Fiscal 2002 was the second consecutive year that the trust experienced a negative yield on its prepaid tuition plan investments. The late increases in tuition for the 2003 academic year also contributed to the current deficit.

Trust Continues Payment of State Loan: The trust will have an outstanding debt to the State in the amount of \$400,000 at the close of fiscal 2003. The trust has budgeted a payment of \$120,000 for fiscal 2004 towards this balance.

Recommended Actions

1. Add section directing the Maryland Prepaid College Trust to continue State loan repayments.

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Operating Budget Analysis

Program Description

The Maryland Prepaid College Trust (MPCT) is an independent State agency established in 1997 (Maryland Annotated Code Article 18, Section 18-1901 through 18-1916 and 18-19A-01 through 18-19A-07). The agency serves the Maryland Higher Education Investment Board (MHEIB), a nine-member body created under Article 18. Four board members serve by virtue of the State office they hold, including the State Treasurer, the State Comptroller, the Secretary of the Maryland Higher Education Commission, and the State Superintendent of Schools. The Governor appoints the five remaining members of the board.

The board administers the MPCT and oversees the administration of the Maryland College Investment Plan (MCIP). Participation in MPCT began in spring 1998; the trust's sixth enrollment period began in November 2002. MPCT provides Maryland and the District of Columbia residents with a way to pay for a child's future college education based on today's tuition costs at Maryland public colleges and universities. Even those who live out-of-state but apply for a child that is a Maryland or District of Columbia resident are eligible. The purchaser chooses the number of years of tuition and mandatory fees that they wish to buy and how they wish to pay – single, monthly, or annual payments. If the child enrolls in a Maryland public college, the trust will pay full in-state tuition and mandatory fees to the college. If the child attends an eligible private or out-of-state college, the average tuition of the Maryland public colleges weighted by in-state enrollment will be paid. Participants also benefit from federal and State tax incentives and a legislative guarantee.

MCIP became available for enrollment in December 2001. The plan is managed by T. Rowe Price and provides families with a second savings option by allowing an individual to select from 10 different investment portfolios and determine the amount and frequency of the contributions to an account. Contributions plus investment earnings are available for eligible higher education expenses including tuition, mandatory fees, room and board, and other qualified expenses as defined by Section 529 of the Internal Revenue Code. The investment plan has similar tax benefits to the prepaid college trust but is not guaranteed by the State; therefore, the individual takes on a greater risk in exchange for the possibility of greater return.

Performance Analysis: Managing for Results

Exhibit 1 shows selected performance data from the trust's Managing for Results (MFR) submission. The measures focus on marketing activities, and, to some extent, the effectiveness of those marketing efforts. The single goal under the trust's MFR submission is to create and maintain statewide awareness of the State's two college savings plans.

Exhibit 1

**Program Measurement Data
Maryland Prepaid College Trust
Fiscal 1999 through 2004**

	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>Est. FY 03</u>	<u>Goal FY 04</u>
Enrollment kits distributed	55,000	50,000	40,375	50,000	50,000	50,000
Paid television and radio spots	3,550	n/a	3,854	2,000	2,000	2,000
Direct mailings	107,000	160,000	48,411	140,000	140,000	140,000
Calls to toll-free number*	22,459	n/a	21,398	45,689	21,000	40,000
Web hits*	22,492	n/a	64,376	195,488	70,000	150,000
% of new applications received online	n/a	n/a	31	31	35	40
% of new applicants who attended public school presentations	n/a	n/a	14	15	18	18

* Measures activity during enrollment period only.

Source:

The number of enrollment kits distributed was the highest during the first year of enrollment and is expected to remain at 50,000 for the 2004 enrollment period. Paid radio and television spots increased between fiscal 1999 and 2001 but declined to 2,000 in fiscal 2002 and are expected to remain at that level in both fiscal 2003 and 2004. Direct mailings, after decreasing by nearly 70% in fiscal 2001, increased again in fiscal 2002 and are expected to remain at that level for 2003 and 2004. Calls to the toll-free number fluctuate greatly from year to year, as do the number of web hits. The percent of applications received online does not increase with the number of web hits, although the two should correlate. Finally, the percent of applicants who attended public school presentations remains relatively low, at 18% expected in fiscal 2004.

The trust does not include the number of applications received and the number of contracts procured as part of its MFR, making it difficult to measure the effectiveness of the marketing tools. **The department recommended in the previous two years that the trust add these measures to its MFR submission, as well as the percentage of Maryland and District of Columbia residents who purchase a contract or investment account, and the number of accounts purchased by low income families. DLS recommends that the trust brief the committees on these measurements and how it will increase the scope of its MFR in future years.**

Participation in the Prepaid College Trust

Exhibit 2 shows the applications and contracts purchased for each enrollment period. At the end of the last full enrollment period, the trust reported 16,284 applications and total contracts at 14,775. The

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2002-2003 enrollment period is still in effect, with the number of applications at 1,671 as of February 14, 2003. The final number of contracts from the current enrollment period will not be known until the first payments are due in August 2003.

Exhibit 2

Participation in the Maryland Prepaid College Trust

<u>Enrollment Period</u>	<u>Prepaid Applications</u>	<u>Prepaid Contracts Purchased</u>	<u>Investment Plan Participants</u>
Spring 1998	1,365	1,048	n/a
Spring 1999	2,872	2,354	n/a
1999 – 2000	1,886	1,608	n/a
2000 – 2001	5,772	5,509	n/a
2001 – 2002	4,389	4,207	14,750
2002 – 2003	1,671*	n/a	1,750*
Total	16,284**	14,726	16,500

*As of February 14, 2003

** Total does not include incomplete data for 2002-2003 period.

Source: Maryland Prepaid College Trust; Department of Legislative Services

Estimated Revenues

As shown in **Exhibit 3**, the fiscal 2004 nonbudgeted allowance totals \$1.7 million. This is a decrease of \$61,000, or 3.4% over the fiscal 2003 working budget. In past years, the trust relied on revenue from the actuarial reserve, but due to market conditions, the trust reports an actuarial deficit in the fiscal 2003 working appropriation.

Exhibit 3

Maryland Prepaid College Trust Nonbudgeted Revenue

	<u>FY 02 Actual</u>	<u>FY 03 Working</u>	<u>FY 04 Estimate</u>
Application fee	\$748,632	\$922,500	\$885,000
Program contributions	919,724	848,631	825,427
Actuarial reserve-license fee	165,060	0	0
Total Revenues	\$1,833,416	\$1,771,131	\$1,710,427

Source: Maryland Prepaid College Trust

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The revenue sources are described briefly below.

- **Application Fees:** Those applying to the prepaid program during the winter 2002/spring 2003 enrollment period must pay a \$75 fee. This is a reduction of \$15 from the previous enrollment period, an action taken by the prepaid to offset the poor market conditions and attract more enrollees.
- **Operating Fees from Contract Payments:** Contract prices include fees to cover the trust’s operating expenses. Therefore, a small percentage of every payment made by a contract holder is to be spent by the trust, while a vast majority of the payment is invested for tuition and mandatory fees of the beneficiary. An administrative fee of 2.25% was factored into the winter 2002/spring 2003 contract price. This is a decrease of 0.25% from the 2001-2002 enrollment period.
- **Actuarial Reserve (Investment Surplus):** The trust had used this revenue source to support its fall 2000/winter 2001 marketing campaign and in fiscal 2002 to support part of the software license cost. The trust did not draw down its reserve in fiscal 2003 and will not in fiscal 2004.

Proposed Spending

The trust’s proposed spending plan for fiscal 2004 is presented in **Exhibit 4**.

Exhibit 4

Maryland Prepaid College Trust
(\$ in Thousands)

<u>Proposed Spending</u>	<u>FY 04</u>
Salary and wages	\$616
Clerical support	35
Communication/telecommunication charges	150
Garage rent for employee parking.....	10
Contractual services, including record-keeping, information technology support and maintenance, consulting fees, and a decrease in software licenses	696
Office supplies and materials	41
Insurance, subscriptions, and other fixed charges	42
Loan repayments to the State	120
Total	\$1,710

Note: Numbers may not sum to total due to rounding.

Issues

1. Trust Reports \$29.8 Million Deficit for Fiscal 2002

The results of the actuarial evaluation of the trust as of June 30, 2002, show that the trust experienced an actuarial deficit of \$29.8 million for fiscal 2002. The three primary factors contributing to this are (1) the annual projected future increase in tuition was increased from 5% to 6%; (2) investment results were lower than expected; and (3) tuition and fee increases for the 2002-2003 academic year were larger than expected. However, the trust is currently 89% funded, with current net assets of \$237.8 million and current liabilities of \$268.3 million.

Change in Pricing Assumptions

Over half of the deficit, \$15.1 million, is due to the increase in pricing assumptions for tuition in future years. The contract price includes an estimate for tuition increases each year following the year of the enrollment. Prior to fiscal 2001 and 2002, the pricing reflected an average tuition increase of 5.5% each year. In light of the recent tuition increases, the trust is now assuming an average annual increase of 6% that more accurately reflects projected tuition increases. This increase is reflected in the contract prices of the current (2002-2003) enrollment period and the pricing of future contracts. However, it creates an actuarial deficit because the trust is assuming an increased liability in future years for all of the contracts purchased before the fiscal 2003 enrollment period; those contract prices are based on a 5.5% average annual increase rather than 6%. The trust will need to make up this deficit in future years either through higher investment returns or increased contract prices for new enrollees.

Loss on Investments

The second significant factor was the negative effect of the unrealized loss on investments. In addition to the unrealized loss, the trust did not generate the earnings expected on investments; an investment rate of return assumption of 7.5% was included in the trust's pricing. Investment performance is accountable for 37%, or \$11.1 million, of the total deficit.

The average age of enrollees is eight years, which gives the trust's investments nearly nine years before enrollees begin to draw on their benefits. For usual investment cycles, this is enough time for poor investments to rebound, negating years of poor investment performance. The trust expects to earn back the difference between its investment performance and the expected 7.5% return in future years. The trust currently has enough assets to fund payouts through fiscal 2018.

The trust should comment on its current investment strategies and any changes resulting from the recent losses.

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Yearly Tuition and Fee Increases

Key assumptions in the pricing of prepaid contracts include average annual tuition and mandatory fee increases of 6% and 10%, respectively. The weighted average tuition for in-state students at 4-year public universities increased 7.99% from academic years 2001 to 2002, and 4.27% from fiscal 2000 to 2001. However, after adopting a tuition increase of 4% for the 2002-2003 academic year, the University System of Maryland (USM) raised tuition rates another 1.5% in May of 2002 due to the State's fiscal crisis. The additional tuition and mandatory fee increases increased the 2003 academic year costs to an average of 6.2% and 15.3%, respectively.

The prepaid enrollment period is timed to coincide with various school activities and the end of the calendar year so that enrollees can take advantage of tax benefits. Tuition and fee prices were set by USM in early fall of 2001, for the 2002-2003 academic year. Enrollment in the trust began in October 2001 and ran through March 2002 – with prices based on the 2002-2003 academic year. Therefore, when tuition and fee rates were raised in May 2002 for the 2002-2003 academic year, the contract prices for 2003, set at a lower rate, did not reflect the true cost of tuition and fees. The higher than expected tuition increase accounts for \$3.6 million of the deficit.

The difference between the 2003 contract prices and the actual cost of tuition and fees will not be regained through the market in future years. The trust will amortize this deficit over the next five years, increasing contract prices during those years. While this solves the problem of the deficit, it means that contract-purchasers during those years are paying more than “today's prices for tomorrow's tuition.” For the future, the trust will assume a higher tuition increase, hoping to prevent pricing contracts that are too low.

2. Trust Continues Payment of State Loan

The trust was granted loans in 1998, 1999, and 2000 totaling \$650,000 from the Maryland Higher Education Commission (MHEC), of which \$130,000 has been repaid as of June 30, 2002. The loans are non-interest bearing. In fiscal 2003 the trust will repay another \$120,000 of the loan, leaving an outstanding balance of \$400,000. The fiscal 2004 budget includes a payment of \$120,000, which will reduce the outstanding balance to \$280,000.

Recommended Actions

1. Add the following section:

Section XX. AND BE IT FURTHER ENACTED, That the General Assembly intends that Maryland Prepaid College Trust continue making its State loan repayments in fiscal 2004 and repayments be made in each year thereafter until the entire balance is repaid. The amount repaid in fiscal 2004 should be no less than \$120,000.

Explanation: Between fiscal 1998 and 2000, the Maryland Prepaid College Trust received \$650,000 in interest-free State loans. The trust repaid \$130,000 as of June 2002 and will repay \$120,000 more during fiscal 2003. The trust has indicated its ability to pay another \$120,000 in fiscal 2004.

Current and Prior Year Budgets

**Current and Prior Year Budgets
Maryland Prepaid College Trust
(\$ in Thousands)**

	<u>Nonbudgeted Fund</u>	<u>Total</u>
Fiscal 2002		
Estimated Budget	\$1,786	\$1,786
Change	-118	-118
Actual Expenditures	\$1,668	\$1,668
Fiscal 2003		
Estimated Budget	\$1,518	\$1,518
Change	253	253
Working Budget	\$1,771	\$1,771

Note: Numbers may not sum to total due to rounding.

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Appendix 2

Object/Fund Difference Report
Maryland Prepaid College Trust

<u>Object/Fund</u>	<u>FY 02 Actual</u>	<u>FY 03 Working Appropriation</u>	<u>FY 04 Allowance</u>	<u>FY 03 - FY 04 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	6.50	9.50	9.50	0	0%
02 Contractual	0.50	1.00	1.00	0	0%
Total Positions	7.00	10.50	10.50	0	0%
Objects					
01 Salaries and Wages	\$ 527,476	\$ 554,639	\$ 627,728	\$ 73,089	13.2%
02 Technical & Spec Fees	50,233	30,000	35,389	5,389	18.0%
03 Communication	157,668	129,050	148,946	19,896	15.4%
04 Travel	11,128	15,000	12,000	-3,000	-20.0%
06 Fuel & Utilities	7,016	5,500	5,500	0	0%
07 Motor Vehicles	9,540	9,550	9,540	-10	-0.1%
08 Contractual Services	741,462	824,653	696,403	-128,250	-15.6%
09 Supplies & Materials	11,259	25,000	14,500	-10,500	-42.0%
11 Equip - Additional	13,532	16,000	15,000	-1,000	-6.3%
13 Fixed Charges	39,039	41,739	39,399	-2,340	-5.6%
14 Land & Structures	100,000	120,000	120,000	0	0%
Total Objects	\$ 1,668,353	\$ 1,771,131	\$ 1,724,405	-\$ 46,726	-2.6%
Funds					
07 Non-budgeted Fund	\$ 1,668,353	\$ 1,771,131	\$ 1,724,405	-\$ 46,726	-2.6%
Total Funds	\$ 1,668,353	\$ 1,771,131	\$ 1,724,405	-\$ 46,726	-2.6%

Note: Fiscal 2003 appropriations and fiscal 2004 allowance do not include cost containment and contingent reductions.

Fiscal Summary						
Maryland Prepaid College Trust						
<u>Unit/Program</u>	<u>FY 02</u> <u>Actual</u>	<u>FY 03</u> <u>Legislative</u> <u>Appropriation</u>	<u>FY 03</u> <u>Working</u> <u>Appropriation</u>	<u>FY 02 – FY 03</u> <u>% Change</u>	<u>FY 04</u> <u>Allowance</u>	<u>FY 03 – FY 04</u> <u>% Change</u>
41 Maryland Prepaid College Trust	\$ 1,668,353	\$ 1,517,765	\$ 1,771,131	6.2%	\$ 1,724,405	-2.6%
Total Expenditures	\$ 1,668,353	\$ 1,517,765	\$ 1,771,131	6.2%	\$ 1,724,405	-2.6%
Non-budgeted Fund	\$ 1,668,353	\$ 1,517,765	\$ 1,771,131	6.2%	\$ 1,724,405	-2.6%
Total Appropriations	\$ 1,668,353	\$ 1,517,765	\$ 1,771,131	6.2%	\$ 1,724,405	-2.6%

Note: Fiscal 2003 appropriations and fiscal 2004 allowance do not include cost containment and contingent reductions.