

R60H
Maryland Prepaid College Trust

Operating Budget Data

(\$ in Thousands)

	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 02-04</u> <u>Change</u>	<u>FY 05</u>	<u>FY 04-05</u> <u>Change</u>
Operations	\$927	\$993	\$1,049	\$122	\$1,117	\$68
Contractual Services	741	859	715	-26	758	43
Grants	0	0	0	0	0	0
Adjusted Grand Total	\$1,668	\$1,852	\$1,764	\$96	\$1,875	\$111
Nonbudgeted	1,668	1,852	1,764	96	1,876	112
Annual % Change		11.0%	-4.8%		6.4%	

- The Maryland Prepaid College Trust is expecting a \$111,920 increase in revenues in fiscal 2005 due to increased program fees.

Personnel Data

	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 02-04</u> <u>Change</u>	<u>FY 05</u>	<u>FY 04-05</u> <u>Change</u>
Regular Positions	6.5	9.5	9.5	3.0	9.5	0.0
Contractual FTEs	0.5	1.0	1.0	0.5	1.0	0.0
Total Personnel	7.0	10.5	10.5	3.5	10.5	0.0

Vacancy Data: Regular Positions

Turnover Expectancy	0.00	0.00%
Positions Vacant as of 12/31/03	0.00	0.00%

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

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Analysis in Brief

Major Trends

Online Enrollments Increasing: The trust emphasizes its web site in its marketing campaigns and has seen large increases in the percent of on-line enrollments.

Percent of Marylanders under 18 Enrolled in Savings Plans Is Increasing: The College Savings Plan of Maryland is making significant improvements in the percent of Marylanders under the age of 18 that have either savings or prepaid accounts. In fiscal 2005, 6% of Maryland residents under 18 are expected to have accounts compared to 2.5% in fiscal 2002.

Issues

Actuarial Deficit Increases Due to Tuition Hike: The trust reported an actuarial deficit of \$31 million as of June 30, 2002, and the trust was 89% funded. The actuarial deficit grew to \$69.9 million as of June 30, 2003, and the trust was 82% funded. The cause of the actuarial deficit's increase was the large tuition rate increase for the 2003 to 2004 academic year. However, the actuarial deficit has now been reduced to \$54.5 million as of December 31, 2003, due to strong investment earnings.

Trust Continues Payment of State Loan: The trust will have an outstanding debt to the State in the amount of \$280,000 at the close of fiscal 2004. The trust has budgeted a payment of \$120,000 for fiscal 2005 towards this balance.

Trust Introduces Legislation for Exemption from State Procurement Laws: The trust currently has assets in excess of \$200 million and is seeking the ability to use active managers of funds to save money and allow for a more effective process for asset reallocation.

Recommended Actions

1. Add Section __ requiring the Maryland Prepaid College Trust to continue State loan repayments.

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Operating Budget Analysis

Program Description

The College Savings Plans of Maryland (CSPM) 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 College Savings Plans of Maryland Board, a 10-member body created under Article 18. Five board members serve by virtue of the State office they hold, including the State Treasurer, the State Comptroller, Secretary of the Maryland Higher Education Commission, the State Superintendent of Schools, and as of July 1, 2003, the Chancellor of the University System of Maryland. The Governor appoints the five remaining members.

The board administers the prepaid trust and oversees the administration of the College Savings Plans. Administration for the trust and the investment plan is the responsibility of CSPM. Participation in the trust began in spring 1998; the trust's seventh enrollment period began in November 2003. The trust 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.

The investment plan 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 12 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 submission. The CSPM has two goals: (1) create and maintain statewide awareness of the College Savings plans, and (2) achieve measurable increases in college savings among Maryland families. Therefore, the measures focus on marketing, the effectiveness of marketing and use of the Internet, as well as the number of participants and size of account assets.

Exhibit 1
Program Measurement Data
Maryland Prepaid College Trust
Fiscal 2001 – 2005

	<u>Actual</u> <u>2001</u>	<u>Actual</u> <u>2002</u>	<u>Actual</u> <u>2003</u>	<u>Est.</u> <u>2004</u>	<u>Est.</u> <u>2005</u>	<u>Total</u> <u>Change</u> <u>01-03</u>	<u>Total</u> <u>Change</u> <u>03-05</u>
Presentations in Maryland State Schools	175	190	200	200	200	14%	0.0%
% of new applicants that attended public school presentations	18%	18%	20%	20%	20%	11%	0.0%
% of new Investment Plan enrollments received on-line	n/a	25%	25%	30%	35%		40%
% of new Prepaid Trust enrollments received on-line	n/a	31%	44%	50%	50%		14%
Number of students attending a State public institution using the Prepaid Trust	n/a	100	500	1,000	2,000		300%
Number of students under the age of 18 enrolled in the Prepaid Trust	n/a	14,300	18,300	22,000	26,000		42%
Number of enrolled students in both plans as percent of State population under age 18	n/a	2.5%	3.5%	4.8%	6.0%		71%

Source: College Savings Plans of Maryland

Towards the marketing and awareness goal, the first measure in Exhibit 1 shows the number of presentations given in Maryland public and private schools. Since fiscal 2001, presentations have increased to about 200 per year and are expected to remain at that level. The number of attendees is not shown in the data but has averaged 4,600 total each year for the past three years. Accordingly, the percent of families that enroll in one of the plans that attended a presentation increased as presentations increased but has held steady at 20% since fiscal 2003.

CSPM makes all of the necessary forms and information available on its web site. The web site makes the enrollment process easier on both the families and the trust and is emphasized in the marketing campaigns. An increasing number of families enrolling in the 529 plans are forecast to use the web site. From fiscal 2002 to 2005, a ten percentage point increase in the number enrolling in the investment plan on-line and a twenty percentage point increase in the number enrolling in the prepaid plan on-line is estimated.

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The next measure looks at the number of students enrolling in a Maryland public higher education institution using funds from the prepaid plan. In fiscal 2002, academic year 2001 to 2002, the program was in its third year, and only 100 students were using funds saved through the program. By fiscal 2005 the number is estimated at 2,000 students.

Despite a large increase in contract prices from the fiscal 2002 enrollment period to the fiscal 2003 enrollment period, the number and percent of Marylanders under the age of 18 that are enrolled in the program is expected to increase. By fiscal 2005, the trust is estimating that 6% of this population, 83,660 people, will be enrolled in either the prepaid or the savings plan.

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 in 2003, the trust reported 20,854 applications and total contracts at 19,540. The 2003 to 2004 enrollment period is still in effect, with the number of applications at 1,224 as of February 20, 2004. The final number of contracts for the current enrollment period will not be known until the first payments are due in August 2004; however, the trust is estimating 4,000 for the current enrollment period and 3,500 in future years due to significant price increases and increased market penetration.

Exhibit 2 Participation in the Maryland Prepaid College Trust

<u>Enrollment Period</u>	<u>Applications</u>	<u>Contracts Purchased</u>	<u>Percentage Increase in Price</u>
Spring 1998	1,356	1,102	-
Spring 1999	2,720	2,527	6.5%
1999-2000	1,863	1,620	5.5%
2000-2001	5,599	5,319	4.3%
2001-2002	4,389	4,207	4.3%
2002-2003	4,927	4,765	24.0%
2003-2004*	1,224	969	26.0%
Total	22,078	20,509	

* As of February 20, 2003

Note: Percent increase in price is based on the average of the lump sum prices for a four-year university plan for infants and 9th graders.

Source: Maryland Prepaid College Trust; Department of Legislative Services

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The percent increases in contract prices are also shown in Exhibit 2. During the first five years of the prepaid plan, the increases were modest, and in some cases, less than the average tuition rate increase. The large increase in the 2002 to 2003 enrollment period did not seem to affect interest and enrollments in the plan – the trust surpassed its goal of 4,000 applicants.

Estimated Revenues

As shown in **Exhibit 3**, the fiscal 2005 revenues total \$1.87 million. This is an increase of \$0.1 million, or 6.3% over fiscal 2004. Until fiscal 2002, the trust relied on revenue from the actuarial reserve, but due to higher-than-expected tuition increases and an increased projection for future increases, the trust reports an actuarial deficit in the fiscal 2004 working appropriation.

Exhibit 3 Maryland Prepaid College Trust Nonbudgeted Revenue

	<u>FY 2003 Actual</u>	<u>FY 2004 Working</u>	<u>FY 2005 Estimates</u>
Application Fees	\$922,500	\$885,000	\$864,511
Program Contributions	848,631	825,427	1,011,277
Total Revenues	\$1,852,494	\$1,763,868	\$1,875,788

Source: Maryland Prepaid College Trust

The revenue sources are described briefly below and have not changed from the previous enrollment period.

- **Application Fees:** Those applying to the prepaid program during the winter 2003/spring 2004 enrollment period must pay a \$75 fee.
- **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 2.5% was factored into the winter 2003/spring 2004 contract price.
- **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.

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Proposed Spending

The Trust's proposed spending for fiscal 2005 is presented in **Exhibit 4**.

Exhibit 4
Governor's Proposed Budget
Maryland Prepaid College Trust
(\$ in Thousands)

	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 04 - 05</u>	<u>FY 04 - 05</u>
	<u>Working</u>	<u>Allowance</u>	<u>\$ Change</u>	<u>% Change</u>
<u>Expenditures</u>				
Salaries and wages	\$616	\$705	\$89	14.4%
Clerical support	36	35	-1	-2.8%
Communication/telecommunication charges	162	150	-12	-7.4%
Garage rent (employee parking)	10	10	0	0%
Contractual services	343	345	2	0.6%
Marketing	312	350	38	12.2%
Office supplies, materials, and equipment	102	96	-6	-5.9%
Insurance, subscriptions, and other fixed charges	63	64	1	1.6%
Loan repayment to state	120	120	0	0%
Total Nonbudgeted Funds	\$1,764	\$1,875	\$111	6.3%

Source: College Savings Plans of Maryland

Issues

1. Actuarial Deficit Increases Due to Tuition Hike

As of December 31, 2003, the actuary for the trust reported that the program has an actuarial deficit of \$54.5 million and is 89.4% funded, reflecting better than estimated market returns in the last half of 2003. This is an improvement over the actuarial evaluation in June 2003, which reported the Prepaid Trust had an actuarial deficit of \$69.9 million and that only 82% of the program was funded.

The trust experienced its first actuarial deficit of \$31 million at the end of fiscal 2002, due to lower-than-expected investment returns, large tuition and fee increases, and an increase in the annual future projections for tuition increases. The increase of the actuarial deficit from \$31 million to \$54.5 million is a result of two factors: tuition and mandatory fee increases for the 2003 to 2004 academic year were larger than anticipated; and the projected future tuition increase rose from 6% annually to 11% for the 2004 to 2005 academic year and then 6% for each following year.

Investment earnings for fiscal 2003 have been on target, earning 7.51% compared to projections of 7.5%. The actuarial deficit, therefore, is a result of the large and unpredictable tuition increases at Maryland's public higher education institutions.

Addressing the Actuarial Deficit

Last year the trust amortized \$20 million of the \$31 million actuarial deficit that was due to unanticipated tuition increases in the first of five years, building the cost into the contract prices for the 2003 enrollment period. In the current enrollment period, which continues through March 19, 2004, the board is continuing to amortize the losses in the second year of the five-year amortization period that began last year, and is amortizing the additional losses in the first of an eight year amortization period; the additional losses were caused by the 19.4% average increase in tuition from fiscal 2003 to 2004. The projected tuition increase for that same time period was 9.75%.

The trust is working to improve communications with the University System of Maryland by adding the Chancellor as an ex-officio board member of the trust. The trust hopes this will enable the board to make decisions about future contract pricing assumptions based on the most complete and informative data available. It was with the Chancellor's advice that the trust assumed an 11% increase in tuition rates for the 2004 to 2005 academic year, 9% for 2005 to 2006, 8% in 2006 to 2007, and 6% in future years. Mandatory fees are assumed to increase 10% each year.

Effects of High Contract Prices

The amortization has resulted in significant increases in the contract prices each year since fiscal 2002. In fiscal 2002, the four-year university plan cost approximately \$18,000. The same plans cost \$25,000 in fiscal 2003 and during the current enrollment period costs approximately \$31,000. The

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increases in pricing have not affected the number of applicants and enrollees to the program; however, they will probably affect the types of families that can enroll.

The trust was designed with the goal of helping families save for college that would not have the resources to otherwise afford tuition each year. Since contract prices are increasing and require a significant portion of a family's disposable income (the price per month for a first-grader in the four-year university plan is \$350), the trust will probably see lower-income families priced out of the savings plans. **The trust should comment on the high contract price increases in the past two years and the effects this will have on the types of families that are served by the program.**

2. Trust Continues Repayment 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 \$250,000 has been repaid as of June 30, 2003. The loans are non-interest bearing. In fiscal 2004 the trust will repay another \$120,000 of the loan, leaving an outstanding balance of \$280,000. The trust has budgeted to repay another \$120,000 in fiscal 2005, which will reduce the outstanding balance to \$160,000.

3. Trust Introduces Legislation for Exemption from State Procurement Laws

House Bill 894 is a departmental bill that requests the CSPM be exempt from the State procurement laws for services of managers to invest the assets of the trust and for expenditures to manage, maintain, and enhance the value of the trust's assets. The trust estimates savings from this exemption of approximately \$348,848 in fiscal 2005 due to lower investment manager costs; aggregate savings through fiscal 2009 are estimated at \$2.3 million.

The trust is currently under the provisions of the State Procurement Article, which are designed to ensure that contracts are competitive and awards are based on merit and lowest price. The trust is governed by the CSPM Board, which governs the investment of funds based on recommendations by the board's investment advisor. Currently, the trust invests in retail mutual funds. Since the assets of the trust exceed \$200 million, the board and its investment advisor believe it would be more cost-effective for the board to utilize active managers of funds because the fees would be reduced. Under current law, procurements take several months, which impedes the board's ability to effectively reallocate assets. The exemption would still require the board to review and select investment options in accordance with a stated investment policy, but it would permit the board to enter into cost saving fee structures that are not currently permitted. This exemption is the same that is currently utilized by the State's Retirement Plan.

Recommended Actions

1. Add the following section:

SECTION . AND BE IT FURTHER ENACTED, That the General Assembly intends that Maryland Prepaid College Trust continue making its State loan repayments in fiscal 2005 and repayments be made in each year thereafter until the entire balance is repaid. The amount repaid in fiscal 2005 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 \$250,000 over fiscal 2002 and 2003, and will repay another \$120,000 in fiscal 2004. The trust has indicated its ability to pay another \$120,000 in fiscal 2005. This will leave a remaining debt of \$160,000.

Current and Prior Year Budgets

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

	Nonbudgeted <u>Fund</u>	<u>Total</u>
Fiscal 2003		
Estimated Budget	\$1,771	\$1,771
Change	81	81
Actual Expenditures	\$1,852	\$1,852
Fiscal 2004		
Estimated Budget	\$1,710	\$1,710
Change	54	54
Working Appropriation	\$1,764	\$1,764

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

**Object/Fund Difference Report
Maryland Prepaid College Trust**

<u>Object/Fund</u>	<u>FY03 Actual</u>	<u>FY04 Working Appropriation</u>	<u>FY05 Allowance</u>	<u>FY04 - FY05 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	9.50	9.50	9.50	0	0%
02 Contractual	1.00	1.00	1.00	0	0%
Total Positions	10.50	10.50	10.50	0	0%
Objects					
01 Salaries and Wages	\$ 636,164	\$ 616,500	\$ 704,838	\$ 88,338	14.3%
02 Technical & Spec Fees	31,539	36,500	12,018	-24,482	-67.1%
03 Communication	104,288	149,500	151,386	1,886	1.3%
04 Travel	11,803	12,000	12,000	0	0%
06 Fuel & Utilities	6,633	5,500	6,500	1,000	18.2%
07 Motor Vehicles	9,360	9,500	9,500	0	0%
08 Contractual Services	859,126	715,079	758,257	43,178	6.0%
09 Supplies & Materials	19,536	25,000	25,000	0	0%
11 Equip - Additional	14,563	16,250	12,000	-4,250	-26.2%
13 Fixed Charges	39,482	58,039	64,289	6,250	10.8%
14 Land & Structures	120,000	120,000	120,000	0	0%
Total Objects	\$ 1,852,494	\$ 1,763,868	\$ 1,875,788	\$ 111,920	6.3%
Funds					
07 Nonbudgeted Fund	\$ 1,852,494	\$ 1,763,868	\$ 1,875,788	\$ 111,920	6.3%
Total Funds	\$ 1,852,494	\$ 1,763,868	\$ 1,875,788	\$ 111,920	6.3%

Note: The fiscal 2004 appropriation does not include deficiencies, and the fiscal 2005 allowance does not reflect contingent reductions.

**Fiscal Summary
Maryland Prepaid College Trust**

<u>Unit/Program</u>	<u>FY03 Actual</u>	<u>FY04 Legislative Appropriation</u>	<u>FY04 Working Appropriation</u>	<u>FY03 - FY04 % Change</u>	<u>FY05 Allowance</u>	<u>FY04 - FY05 % Change</u>
41 Maryland Prepaid College Trust	\$ 1,852,494	\$ 1,720,620	\$ 1,763,868	-4.8%	\$ 1,875,788	6.3%
Total Expenditures	\$ 1,852,494	\$ 1,720,620	\$ 1,763,868	-4.8%	\$ 1,875,788	6.3%
Nonbudgeted Fund	\$ 1,852,494	\$ 1,720,620	\$ 1,763,868	-4.8%	\$ 1,875,788	6.3%
Total Appropriations	\$ 1,852,494	\$ 1,720,620	\$ 1,763,868	-4.8%	\$ 1,875,788	6.3%

Note: The fiscal 2004 appropriation does not include deficiencies, and the fiscal 2005 allowance does not reflect contingent reductions.