

R60H
College Savings Plans of Maryland

Operating Budget Data

(\$ in Thousands)

| | <u>FY 06</u> <u>Actual</u> | <u>FY 07</u> <u>Working</u> | <u>FY 08</u> <u>Allowance</u> | <u>FY 07-08</u> <u>Change</u> | <u>% Change</u> <u>Prior Year</u> |
|--------------------|-------------------------------|--------------------------------|----------------------------------|----------------------------------|--------------------------------------|
| Nonbudgeted Fund | \$1,954 | \$2,097 | \$2,122 | \$25 | 1.2% |
| Total Funds | \$1,954 | \$2,097 | \$2,122 | \$25 | 1.2% |

- For fiscal 2008, the College Savings Plans of Maryland (CSPM) expects an increase of \$24,980, or 1.2% over fiscal 2007.
- Health insurance costs decline due to one-time savings of \$35,696. Adjusting for the one-time savings, CSPM's budget increases \$60,676, or 2.9% over fiscal 2007.

Personnel Data

| | <u>FY 06</u> <u>Actual</u> | <u>FY 07</u> <u>Working</u> | <u>FY 08</u> <u>Allowance</u> | <u>FY 07-08</u> <u>Change</u> |
|------------------------|-------------------------------|--------------------------------|----------------------------------|----------------------------------|
| Regular Positions | 11.50 | 11.50 | 13.00 | 1.50 |
| Contractual FTEs | 0.20 | 0.20 | 0.20 | 0.00 |
| Total Personnel | 11.70 | 11.70 | 13.20 | 1.50 |

Vacancy Data: Regular Positions

| | | |
|-----------------------------------|------|-------|
| Turnover, Excluding New Positions | 0.00 | 0.00% |
| Positions Vacant as of 12/31/06 | 0.00 | 0.00% |

- CSPM is expected to hire an additional 1.5 positions in fiscal 2008. CSPM reports that these positions are necessary due to the growth in prepaid trust activity.

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

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Analysis in Brief

Major Trends

Strong Increases in Student Enrollment in Plans and Attendance at Colleges via Trust: In fiscal 2006, enrollment in the investment plan increased by about 10,000 students, enrollment in the prepaid trust increased by 2,200 students, and an additional 100 students are attending college using the prepaid trust.

New Prepaid Trust Accounts Continue to Decline: The past three enrollment periods have resulted in fewer contracts established than in the prior year. CSPM has attributed this to significant increases in the contract price as a result of tuition rate increases.

Issues

Status of the Maryland Prepaid Trust: The trust is now 103% funded primarily due to less than expected tuition increases and greater than expected investment returns.

Maryland's Prepaid Trust Compares Well to Other States' Plans: Four other states started a prepaid plan in the same year that Maryland did. Maryland compares well to those plans.

Status of the Maryland College Investment Plan: Assets have exceeded \$1 billion for the first time. An additional 15,910 accounts have been opened, and the average account balance exceeds \$11,000.

Federal Tax Status: The federal Pension Protection Act has been enacted. The Act makes the tax exempt status of 529 plans permanent.

Recommended Actions

1. Nonbudgeted.

R60H
College Savings Plans of Maryland

Operating Budget Analysis

Program Description

The College Savings Plans of Maryland (CSPM) is an independent agency that administers the State's prepaid college trust and college investment plans, also known as 529 plans after the federal tax code section that authorizes them. These plans are beneficial ways to save because participants pay no State or federal taxes on any earnings, plus they receive an annual State income tax deduction on contributions of up to \$2,500 per account or beneficiary depending on the plan.

CSPM was established in 1997 (Maryland Annotated Code Article 18, Section 18-1901 through 18-1916 and 18-19A-01 through 18-19A-07), and it serves the 10-member College Savings Plans of Maryland Board. The board is directly involved in administration of the prepaid trust, and it oversees and has fiduciary responsibility for both plans. 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 Maryland Prepaid College Trust began in spring 1998. The trust provides Maryland and 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. Those who live out-of-state, but apply for a child residing in Maryland or the District of Columbia, are also eligible. Applicants may choose from one semester to five years of tuition and mandatory fees to be covered at a four-year institution, one or two years at a community college, or a combination. Payments into the trust accounts may be made in single, monthly, or annual installments.

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 a legislative guarantee.

The Maryland College Investment Plan became available in December 2001. The plan allows participants to select among professionally managed investment portfolios and determine the amount and frequency of account contributions. Contributions plus investment earnings are available for eligible higher education expenses including tuition, fees, room and board, and other expenses defined by Section 529 of the Internal Revenue Code. The investment plan is not guaranteed by the State. Participants take on greater risk in exchange for the possibility of greater returns.

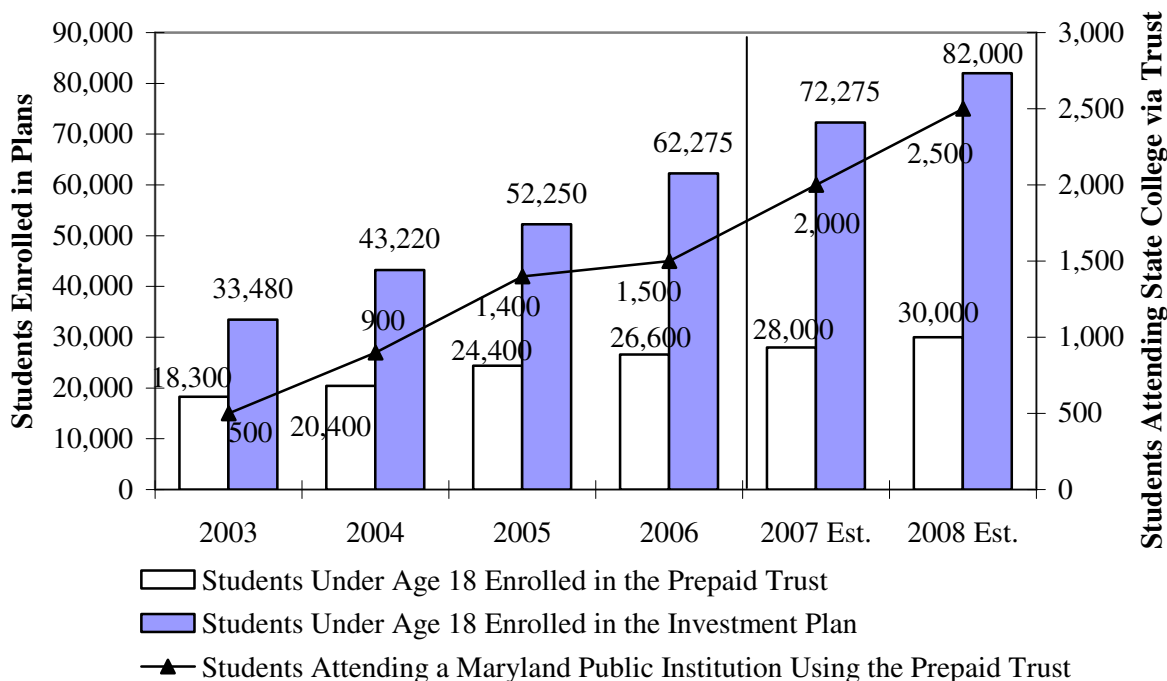
Performance Analysis: Managing for Results

Strong Increases in Student Enrollment in Plans and Attendance at Colleges via Trust

CSPM has a goal to create and maintain statewide awareness of the plans. **Exhibit 1** shows the number of students under the age of 18 enrolled in either plan and the number of students attending a Maryland public institution using the prepaid trust. Enrollment in the investment plan increased by slightly more than 10,000 students in fiscal 2006. This is an 86% increase over fiscal 2003 enrollment levels. Enrollment in the prepaid trust increased from 24,400 students in fiscal 2005 to 26,600 in fiscal 2006. Enrollment growth since fiscal 2003 has not been as robust as the investment plan. The prepaid trust enrollment increased 45% over fiscal 2003.

As the prepaid trust matures, the number of students attending school using the trust is expected to increase. In fact, CSPM reports that 1,500 students are now using the prepaid trust to attend a Maryland public institution. This is a slight increase over fiscal 2005. This number includes all students currently in college using the trust, not just new students.

Exhibit 1
Student Enrollment in Plans, Students Attending College via Trust
Fiscal 2003-2008

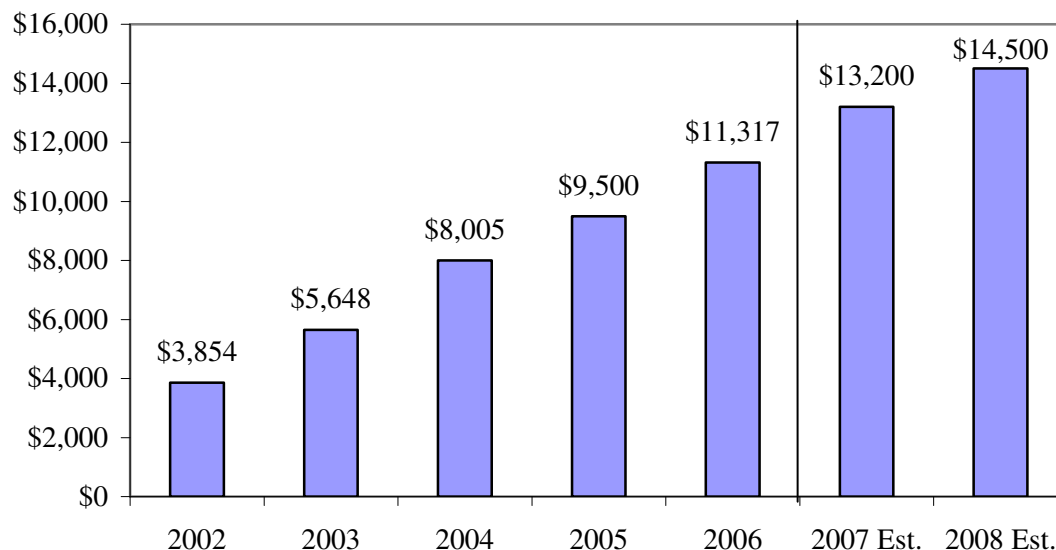


Source: Governor's Budget Books, Fiscal 2008

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The College Savings Plans also aims to increase the average amount in the investment accounts. **Exhibit 2** shows the average balance of investment plan accounts from fiscal 2002 to 2008. In fiscal 2006, the average account balance is \$11,317, exceeding the target of \$11,000. Overall, the average account balance has increased almost 200% since fiscal 2002.

Exhibit 2
Average Balance of Investment Plan Accounts
Fiscal 2002-2008



Source: Governor's Budget Books, Fiscal 2008

To further increase enrollment, CSPM tracks marketing related data. The number of brochures distributed in fiscal 2006 to parents informing them of presentations in their communities was 600,000. This is a decrease from fiscal 2005, and it is estimated that it will continue to decrease in 2007. CSPM reports that the decrease is due to some local school districts moving toward broadcast e-mail messages to parents instead of paper brochures and notices. The schools do include information about CSPM in these e-mails. CSPM organized 117 presentations in Maryland, 1,340 people attended the presentations, and 8% of new applicants had attended a presentation.

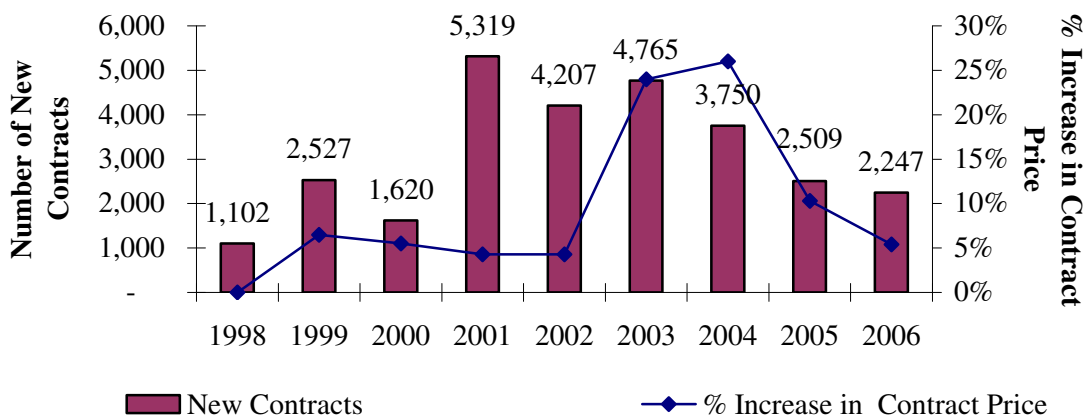
CSPM also retains a marketing firm to help create awareness of the plans. In fiscal 2006, 1,000 television and radio ads were aired, and there were 160,000 direct mailings. The number of enrollment kits that were distributed decreased to 38,000 in fiscal 2006 from 45,000 in 2005. CSPM reports that the primary reason for the decrease is the availability of the kit on their web site. CSPM also tracks the percent of new enrollments received online. For the prepaid trust, 51% of enrollments were online. This is the same as in fiscal 2005. For the investment plan, 26% of enrollments were online in fiscal 2006. In fiscal 2005, 30% of enrollments were online. The number of unique account holders increased by 10,000 to 65,000 in fiscal 2006.

New Prepaid Trust Accounts Continue to Decline

Exhibit 3 shows the number of new contracts established during each enrollment period of the prepaid trust compared to increases in the contract price. The past three enrollment periods have resulted in fewer contracts established than in the prior year. CSPM has attributed this to significant increases in the contract price. These price increases were the result of significant tuition increases at Maryland public colleges. In fiscal 2001, 5,319 new contracts were established, the most since the inception of the prepaid trust. However, contract prices experienced significant increases in fiscal 2003 and 2004. This period of price increases was followed by steady decreases in the number of new contracts. The price increase for the 2005-2006 enrollment period was more moderate, yet there was a 10.4% decrease in the number of new contracts established, the third lowest since the inception of the prepaid trust.

For the 2006-2007 enrollment period, there is no increase in the contract price due to the freeze in undergraduate resident tuition at USM institutions. As of January 31, 2007, there were 664 new enrollments in the prepaid trust. This is compared to 762 new enrollments at the same point during the 2005-2006 enrollment period. Final numbers for the current enrollment period will not be available until the first contract payments are due in August 2007. **CPSM should discuss the decline in new contract purchases, what steps are being taken to increase new contract purchases, and whether it has considered decreasing the contract price, especially with the second consecutive tuition freeze proposed in the Governor’s budget.**

Exhibit 3
New Contracts Established Compared to Contract Price Increases
Fiscal 1998-2006



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

Source: College Savings Plans of Maryland; Department of Legislative Services

Governor’s Proposed Budget

CSPM’s administrative costs for the prepaid trust are supported by revenues from enrollment fees and fees associated with prepaid college trust payments. The fee for those enrolling in the prepaid trust during the 2006-2007 enrollment period remains at \$75. There is an additional administrative fee of 2.5% of all contract payments that is applied to the operating costs of the prepaid trust. This amount is unchanged from prior years.

Exhibit 4 shows revenues collected by CSPM and the expenditures. Revenues from the prepaid trust consist of enrollment fees (\$75), management fees (2.5%), and other fees occasionally charged depending on the activity of the account owner. Revenues from the prepaid trust are expected to decrease in fiscal 2007. Specifically, enrollment fees are expected to decrease 12.1% from fiscal 2006 to 2007 and are expected to remain flat in 2008. Management fees are expected to decrease 18.6% from fiscal 2006 to 2007 and are expected to decrease 7.2% in fiscal 2008.

The projected prepaid trust revenue decline is offset by a projected revenue increase in the investment plan due to the new T. Rowe Price contract that became effective July 1, 2006. Under the new contract, enrollment fees are no longer charged. However, program contributions have also been modified by the new contract. Contributions are based on the total assets in the investment plan. CSPM is paid 0.04% on assets from \$750.0 million to \$1.0 billion. This pay-back percent increases to 0.1% on assets above \$1.0 billion. Based on investment return projections, the contributions are projected to increase by \$0.3 million annually. Program contributions in fiscal 2008 are expected to be \$0.9 million. Total revenue of the CSPM is expected to be \$2.1 million.

Proposed expenditures for CSPM are also shown in Exhibit 4. The largest increase is expected in fuel and utilities (46.4%) due to increases in electricity rates. The second largest increase is in fixed charges (16.1%) primarily due to an increase in rent. The third highest increase is in salaries and wages (8.5%). CSPM is expecting to hire an additional 1.5 positions for fiscal 2008 for a total of 13 regular positions. Overall, total expenditures are expected to equal total revenues in fiscal 2008. The exhibit shows that expenditures exceed revenues in fiscal 2007, which may require a transfer from fund balance. This is not unexpected given the transition to the new T. Rowe Price contract. However, CSPM is anticipating increasing revenues due to the new contract starting in fiscal 2008, as shown by the 8.5% increase. **CSPM should discuss what the excess revenues from fiscal 2006 will be used for as well as the total fund balance.**

Exhibit 4
College Savings Plans of Maryland Revenues and Expenditures
Fiscal 2006-2008

| | <u>2006</u> | <u>Estimated</u> <u>2007</u> | <u>%</u> <u>Increase</u> <u>2006-2007</u> | <u>Estimated</u> <u>2008</u> | <u>%</u> <u>Increase</u> <u>2007-2008</u> |
|--|--------------------|---------------------------------|---|---------------------------------|---|
| Revenues | | | | | |
| Prepaid Trust | | | | | |
| Enrollment Fees | \$151,918 | \$133,500 | -12.1% | \$133,500 | 0.0% |
| Management Fees | 1,440,469 | 1,172,738 | -18.6% | 1,088,218 | -7.2% |
| Total | \$1,592,387 | \$1,306,238 | -18.0% | \$1,221,718 | -6.5% |
| Investment Plan | | | | | |
| Enrollment Fees | \$502,217 | \$0 | -100.0% | \$0 | n/a |
| Program Contributions | 274,923 | 650,000 | 136.4% | 900,000 | 38.5% |
| Total | \$777,140 | \$650,000 | -16.4% | \$900,000 | 38.5% |
| Total Revenues | \$2,369,527 | \$1,956,238 | -17.4% | \$2,121,718 | 8.5% |
| Expenditures | | | | | |
| Salaries, Wages, and Fringe | | | | | |
| Benefits | \$748,903 | \$849,147 | 13.4% | \$921,333 | 8.5% |
| Technical and Special Fees | 55,295 | 43,500 | -21.3% | 43,500 | 0.0% |
| Communication | 122,206 | 154,166 | 26.2% | 154,653 | 0.3% |
| Travel | 11,152 | 12,000 | 7.6% | 12,000 | 0.0% |
| Fuel and Utilities | 12,265 | 10,247 | -16.5% | 15,000 | 46.4% |
| Motor Vehicle Operation and Maintenance | 9,000 | 9,500 | 5.6% | 9,500 | 0.0% |
| Contractual Services – Marketing | 322,999 | 330,000 | 2.2% | 350,000 | 6.1% |
| Other Contractual Services | 264,824 | 518,896 | 95.9% | 425,537 | -18.0% |
| Supplies and Materials | 25,515 | 36,500 | 43.1% | 37,500 | 2.7% |
| Equipment – Additional | 38,630 | 12,000 | -68.9% | 12,500 | 4.2% |
| Fixed Charges | 104,521 | 120,782 | 15.6% | 140,195 | 16.1% |
| Land and Structures * | 238,509 | 0 | -100.0% | 0 | n/a |
| Total Expenditures | \$1,953,819 | \$2,096,738 | 7.3% | \$2,121,718 | 1.2% |
| Excess Revenues | \$415,708 | -\$140,500 | -133.8% | \$0 | -100.0% |

*Of this amount, \$160,000 is the loan repayment to the State. The remaining is an adjustment made by the Department of Budget and Management to account for actual expenditures.

Note: The prepaid trust and the investment plan each have a fund for excess revenues. The revenues may only be used to benefit the families that participate in the plans.

Source: College Savings Plans of Maryland; Governor's Budget Books, Fiscal 2008

Issues

1. Status of the Maryland Prepaid Trust

During the 2005-2006 enrollment period, there were 2,247 new contracts established. The average age of new enrollees was nine years old.

For the fall 2006 semester, 3,287 students became eligible to use their benefits. Of these, 2,508 students, or about 76%, had claimed their tuition benefits as of December 31, 2006. Approximately 40% of these students, or 998, are attending Maryland public colleges. The remaining students are attending private or out-of-state colleges. Of those attending Maryland public colleges, 829 are attending four-year public institutions, and 169 are attending Maryland community colleges. In fiscal 2006, \$11.2 million was paid out to beneficiaries of the prepaid trust. This is almost twice as much as the benefits paid in fiscal 2005 (\$6.3 million).

Actuarial Deficit Turns into a Surplus

At the end of fiscal 2006, the prepaid trust was 103% funded – an increase from 95% funded in fiscal 2005. CSPM cites two primary reasons for the actuarial surplus. The first reason is the weighted average tuition at Maryland's public colleges increased 1.5% for fiscal 2007 instead of the predicted 7.0% that was used to calculate the previous actuarial status. A primary reason for this was the freeze on undergraduate resident tuition at most Maryland public four-year colleges (the increase in tuition at St. Mary's College of Maryland was capped). The second reason is the trust's investment return was 8.0% as compared to the predicted 7.65%. These two factors resulted in the actuarial surplus. **CPSM should comment on the projected actuarial status of the trust in the future.**

2. Maryland's Prepaid Trust Compares Well to Other States' Plans

A survey of prepaid trust plans across the United States was completed by the College Savings Plan Network and distributed at the Network's July 2006 conference. Maryland started its prepaid trust plan in 1998. Five other states also created plans that same year – Illinois, Nevada, South Carolina, Washington, and West Virginia. **Exhibit 5** shows Maryland's plan compared to four of these states – West Virginia is currently not accepting new enrollments, so it was excluded from this exhibit. The exhibit provides a snap shot of various data that allows for the plans to be compared. Asset allocation refers to the percent of investments in either equity or fixed income investments. Maryland has a target of 65% invested in equity and 35% invested in fixed income. Although different types of investment portfolios exist in the states, preventing a perfect comparison, Maryland's rate of return is third highest at 8.4%. Maryland is second highest in assets per account at \$14,286.

Exhibit 5
Maryland's Prepaid Trust vs. Other States
Compares Those Plans Started in 1998

| | <u>Asset Allocation</u> | <u>Rate of Return</u> | <u>Assets Per Account</u> | <u>Accounts Per 1,000</u> | <u>Finance Charges</u> | <u>Lump Sum Payment for Infants</u> | <u>% Funded</u> |
|-----------------|-------------------------|-----------------------|---------------------------|---------------------------|------------------------|-------------------------------------|-----------------|
| Maryland | 65/35 | 8.40% | \$14,286 | 3.95 | 7.50% | \$36,201 | 95% |
| Illinois | 65/35 | 9.00% | 13,516 | 3.75 | 8.00% | 35,925 | 88% |
| Nevada | 50/50 | 7.30% | 7,362 | 4.76 | 7.50% | 15,500 | 106% |
| South Carolina | 50/50 | 6.17% | 17,536 | 1.46 | 7.25% | 44,282 | 77% |
| Washington | 60/40 | 10.07% | 9,930 | 8.63 | 7.50% | 28,000 | 108% |

Notes: West Virginia has a plan that started in 1998, but it is not accepting new enrollments so it is not included in the exhibit. Asset allocation is equity/fixed income and based on fiscal 2006. Rate of return is based on fiscal 2005. Assets per account is based on fiscal 2006. Accounts per 1,000 is the state's 2006 population divided by 1,000 and the fiscal 2006 accounts. Lump sum payment is the four-year plan. Percent funded is based on fiscal 2005. Maryland's plan is 103% funded in fiscal 2006.

For Illinois, Nevada, and Maryland the account holder or the beneficiary must be a state resident. For South Carolina and Washington the beneficiary must be a state resident.

Virginia's plan started in 1996. The asset allocation is 60/40, rate of return is 10.7%, assets per account is \$13,426, accounts per 1,000 is 10.40, finance charge is 8%, lump sum payment for infants is \$35,084, and it is 96% funded.

Source: College Savings Plans of Maryland; Department of Legislative Services

The survey also included the number of accounts in each state's plan. To adjust for variances in state populations, the exhibit shows the number of accounts per 1,000 people in the state as reported for 2006. Again, Maryland falls in the middle with 3.95 accounts per 1,000 people in Maryland and Washington, DC. The plans vary slightly in who may hold or purchase an account. In Illinois and Nevada, either the beneficiary or the account owner must be a state resident. In South Carolina and Washington state, the beneficiary must be a state resident. In Maryland, either the account holder or beneficiary must be a resident of Maryland or Washington, DC in order to participate.

In terms of cost to the account holder, Maryland's lump sum payment for an infant is \$36,201. This is second highest when compared to the other states that established plans in the same year that Maryland did. Another cost to the account holder is the finance charges. These are additional charges when the account holder pays on a monthly or annual basis and not in the lump sum payment. The charges typically equal the projected rate of return on investments. Maryland's finance charge is 7.5% and, again, is in the middle of the range when compared to other states.

At the time of the survey, Maryland's prepaid trust was 95% funded. Currently, the trust is 103% funded.

3. Status of the Maryland College Investment Plan

As of June 30, 2006, an additional 15,190 accounts were opened, 37% of these were for residents of Montgomery County. All other counties each account for 12% or less of the total new accounts opened. The total number of beneficiaries was 69,194 with an average account of \$11,317. Total investments in the plan are currently over \$1 billion, and \$297 million was contributed to accounts in fiscal 2006.

In terms of distribution, approximately \$39.6 million has been distributed to 2,777 unique beneficiaries in fiscal 2006. Compared to distributions made in fiscal 2005, slightly more money has been distributed (\$36.6 million in fiscal 2005), but to fewer beneficiaries (3,282 in fiscal 2005).

4. Federal Tax Status

In August 2006, President George W. Bush signed the Pension Protection Act into law. Without this law, the tax exempt status of the 529 plans would have expired in 2010. This law now makes the tax exempt status of these plans permanent. This law applies to both the prepaid trust and the investment plan.

Recommended Actions

1. Nonbudgeted.

Current and Prior Year Budgets

Current and Prior Year Budgets College Savings Plans of Maryland (\$ in Thousands)

| | <u>Nonbudgeted Funds</u> | <u>Total</u> |
|------------------------------|--------------------------|----------------|
| Fiscal 2006 | | |
| Estimated Budget | \$1,992 | \$1,992 |
| Change | -38 | -38 |
| Actual Expenditures | \$1,954 | \$1,954 |
| Fiscal 2007 | | |
| Estimated Budget | \$2,137 | \$2,137 |
| Change | -40 | -40 |
| Working Appropriation | \$2,097 | \$2,097 |

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

Audit Findings

| | |
|------------------------------|-------------------------------------|
| Audit Period for Last Audit: | February 1, 2002 – January 16, 2006 |
| Issue Date: | May 2006 |
| Number of Findings: | 0 |
| Number of Repeat Findings: | 0 |
| % of Repeat Findings: | 0% |
| Rating: (if applicable) | n/a |

The audit did not disclose any significant findings that warranted inclusion in the audit report.

**Object/Fund Difference Report
College Savings Plans of Maryland**

| <u>Object/Fund</u> | <u>FY06 Actual</u> | <u>FY07 Working Appropriation</u> | <u>FY08 Allowance</u> | <u>FY07-FY08 Amount Change</u> | <u>Percent Change</u> |
|----------------------------|------------------------|---|---------------------------|------------------------------------|---------------------------|
| Positions | | | | | |
| 01 Regular | 11.50 | 11.50 | 13.00 | 1.50 | 13.0% |
| 02 Contractual | 0.20 | 0.20 | 0.20 | 0 | 0% |
| Total Positions | 11.70 | 11.70 | 13.20 | 1.50 | 12.8% |
| Objects | | | | | |
| 01 Salaries and Wages | \$ 748,903 | \$ 849,147 | \$ 921,333 | \$ 72,186 | 8.5% |
| 02 Technical and Spec Fees | 55,295 | 43,500 | 43,500 | 0 | 0% |
| 03 Communication | 122,206 | 154,166 | 154,653 | 487 | 0.3% |
| 04 Travel | 11,152 | 12,000 | 12,000 | 0 | 0% |
| 06 Fuel and Utilities | 12,265 | 10,247 | 15,000 | 4,753 | 46.4% |
| 07 Motor Vehicles | 9,000 | 9,500 | 9,500 | 0 | 0% |
| 08 Contractual Services | 587,823 | 848,896 | 775,537 | -73,359 | -8.6% |
| 09 Supplies and Materials | 25,515 | 36,500 | 37,500 | 1,000 | 2.7% |
| 11 Equip – Additional | 38,630 | 12,000 | 12,500 | 500 | 4.2% |
| 13 Fixed Charges | 104,521 | 120,782 | 140,195 | 19,413 | 16.1% |
| 14 Land and Structures | 238,509 | 0 | 0 | 0 | |
| Total Objects | \$ 1,953,819 | \$ 2,096,738 | \$ 2,121,718 | \$ 24,980 | 1.2% |
| Funds | | | | | |
| 07 Nonbudgeted Fund | \$ 1,953,819 | \$ 2,096,738 | \$ 2,121,718 | \$24,980 | 1.2% |
| Total Funds | \$ 1,953,819 | \$ 2,096,738 | \$ 2,121,718 | \$24,980 | 1.2% |

Note: The fiscal 2007 appropriation does not include deficiencies, and the fiscal 2008 allowance does not reflect contingent reductions.