SB 770

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

Senate Bill 770 (Senator Pinsky)
Budget and Taxation

Higher Education Affordability and Access Act of 2004

This bill establishes a special, nonlapsing Higher Education Investment Fund (HEIF) that contains proceeds from a 12.86% surcharge on corporate income taxes to be imposed from calendar 2004 to 2007. Funding from HEIF will be used to provide additional support to the University System of Maryland (USM) and Morgan State University (MSU), including supplementary fiscal 2005 appropriations. The bill requires the Governor to include in the fiscal 2006 to 2008 State budgets increases of 5% in aggregate general fund and HEIF support for USM and MSU. If the funding increases in the bill are realized, increases in tuition and fees at USM institutions and MSU are limited to 5% per year from fiscal 2005 to 2008.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: HEIF revenues would increase by an estimated $79.8 million in FY 2005 due to the surcharge on corporate income taxes. HEIF expenditures would increase by $27 million in FY 2005 to pay the supplementary appropriations to USM and MSU. Tuition and fee revenues at USM institutions and MSU would decrease from planned revenue levels by an estimated $13.3 million in FY 2005 due to tuition limitations. Compared to current funding projections, general fund expenditures for USM and MSU would decrease beginning in FY 2006 as HEIF expenditures supplant general fund appropriations. Future years reflect 5% annual increases for USM and MSU, continued HEIF revenues, and continued tuition and fee limitations through FY 2008. FY 2009 reflects the impact of FY 2006 to 2008 funding and tuition mandates.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
SF Revenue	$79.8	$60.4	$66.3	$34.4	$0
Higher Ed Rev.	(13.3)	(18.6)	(24.6)	(31.4)	(33.8)
GF Expenditure	0	(18.1)	(36.1)	(34.9)	51.8
SF Expenditure	27.0	51.7	77.6	84.7	0
Net Effect	$39.6	$8.2	$.3	($46.7)	($85.6)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Community colleges could receive smaller annual increases in State aid due to supplanting of general fund appropriations for four-year institutions.

Small Business Effect: Meaningful. Small businesses that are corporate entities would be required to pay a 12.86% surcharge on corporate income taxes, effectively raising the corporate income tax rate from 7.0% to 7.9%.

Analysis

Bill Summary:

Additional Appropriations to Institutions of Higher Education

From the revenues that are credited to HEIF in fiscal 2005, $1.6 million must be appropriated for MSU and $25.4 million must be appropriated for USM. The amounts must be used to offset reductions in tuition and fees imposed by the bill and for other purposes necessary to provide high-quality and affordable post-secondary education.

From fiscal 2006 to 2008, the Governor must include aggregate annual increases for USM and MSU of at least 5% in the State budget, with HEIF supporting no more than 3% of the cumulative increase over the three year period. Increased general fund appropriations must support the rest of the increases.

The additional funding provided through the bill may not supplant funding distributed in accordance with the State’s partnership agreement with the U.S. Department of Education, Office of Civil Rights (OCR), for the State’s four historically Black institutions. The bill states that it is the intent of the General Assembly to continue support for historically Black institutions in the State in accordance with the State’s OCR agreement.

Tuition and Fee Revenues and Policies

For fiscal 2005 to 2008, USM and MSU may not increase resident undergraduate tuition, including mandatory fees, by more than 5% over the rates charged the previous academic year. The 5% limit only applies in fiscal years when the full appropriations required by this bill are provided.

For out-of-state undergraduate students, the Board of Regents of USM must establish a tuition level that is equal to the cost of educating the student, including the costs of facility renewal, equipment for new facilities, academic revenue bond debt expenses, and other expenses related to building and operating State-supported facilities. The number of out-of-state students at a USM institution may not exceed 30% of the total undergraduate student population except at the University of Maryland University College; the University of Maryland Eastern Shore; Bowie State University; and Coppin State College. Students enrolled exclusively in distance education are not included in the calculation. The Board of Regents of USM must study the out-of-state tuition policies of USM constituent universities and their peer institutions and recommend changes, as appropriate, to USM policies.

The boards of regents of USM and MSU must also establish policies to accommodate projected enrollment growth from the 2004-2005 academic year to the 2007-2008 academic year.

Efficiency, Effectiveness, and Accountability

The bill states that it is the intent of the General Assembly that USM and MSU improve their effectiveness and efficiency and reduce their cost structures to provide world class education, research, and public service at below average costs. The bill requires USM to continue its effectiveness and efficiency initiative and requires MSU to implement one. The boards of regents of USM and MSU are required to submit reports detailing management strategies for improved efficiency, strategies for managing enrollment growth effectively, and efforts to improve access and affordability through the use of need-based financial aid. USM must also report on entrepreneurial efforts, including the development and expansion of institution-based research parks.

In any fiscal year in which the Board of Regents of USM implements cost containment measures that involve layoffs or reductions to student services, the board must first submit a report to the General Assembly delineating alternative cost containment measures that were considered, including efforts to reduce administrative costs. In fiscal 2005, USM must attain effectiveness and efficiency savings of at least $17 million. Audit Committee meetings of the Board of Regents of USM must be open to the public and internal audit schedules and reports must be made available for public disclosure.

Finally, nonpublic institutions of higher education that receive State funds are required to report annually to the Maryland Higher Education Commission (MHEC) on the scholarships and grants they award to Maryland students.

Current Law: Funding for USM and MSU are as provided in the annual State budget. It is the intent of the General Assembly, however, that, barring unforeseen economic conditions, the Governor include in the annual budget submission an amount of general fund State support for higher education equal to or greater than the amount appropriated in the prior fiscal year. The goal of the State, as noted in statute, is that State support for higher education operating and capital expenditures comprise 15.5% of general fund revenues.

Subject to the authority and policies of the Board of Regents of USM, the president of each USM constituent institution sets tuition and fees for the institution. The Board of Regents of MSU fixes tuition for the university.

The corporate income tax rate is 7% of Maryland taxable income. There is no surcharge on this amount.

Background: The bill codifies the recommendations of the Special Committee on Higher Education Affordability and Access. The committee was formed to respond to concerns about recent reductions in State support for higher education and subsequent increases in tuition rates at the State's public institutions of higher education. The committee found that fiscal 2004 is the first year that tuition and fee revenues in the aggregate exceed State support at USM institutions. The proposed fiscal 2005 State budget further widens the difference between tuition and fee revenues and State support at USM institutions. The committee's final report indicates that proposed fiscal 2005 tuition and fee revenues per full-time equivalent student ($9,478) are more than $1,700 higher than the proposed fiscal 2005 State support per full-time equivalent student ($7,767).

Many of the concerns that led to the committee's creation began when students at USM institutions endured tuition and fee increases that averaged 18% between fall 2002 and fall 2003. The fiscal 2003 USM budget as proposed in fall 2002 assumed an initial 4% tuition increase. After cost containment reductions in winter 2003, USM adopted an unusual 5% mid-year increase to help offset reduced general fund support. At the beginning of fiscal 2004, following the outcome of the legislative session and actions taken by the Board of Public Works, USM raised fall 2003 tuition rates by an additional 10% or more at several institutions.

The combined actions of the General Assembly and the Board of Public Works reduced the USM budget $67 million in fiscal 2003 and $54.7 million in fiscal 2004. However, the tuition and fee increases brought in $74 million in additional revenues, offsetting 61% of the reduced general funds. The proposed fiscal 2005 State budget provides the same level of State support for USM and MSU that was provided in fiscal 2004, but additional resident undergraduate tuition and fee revenues of $88.6 million are assumed in the proposed fiscal 2005 State budget. **Exhibit 1** shows the fall 2002, fall 2003, and proposed fall 2004 tuition rates at USM institutions and MSU.

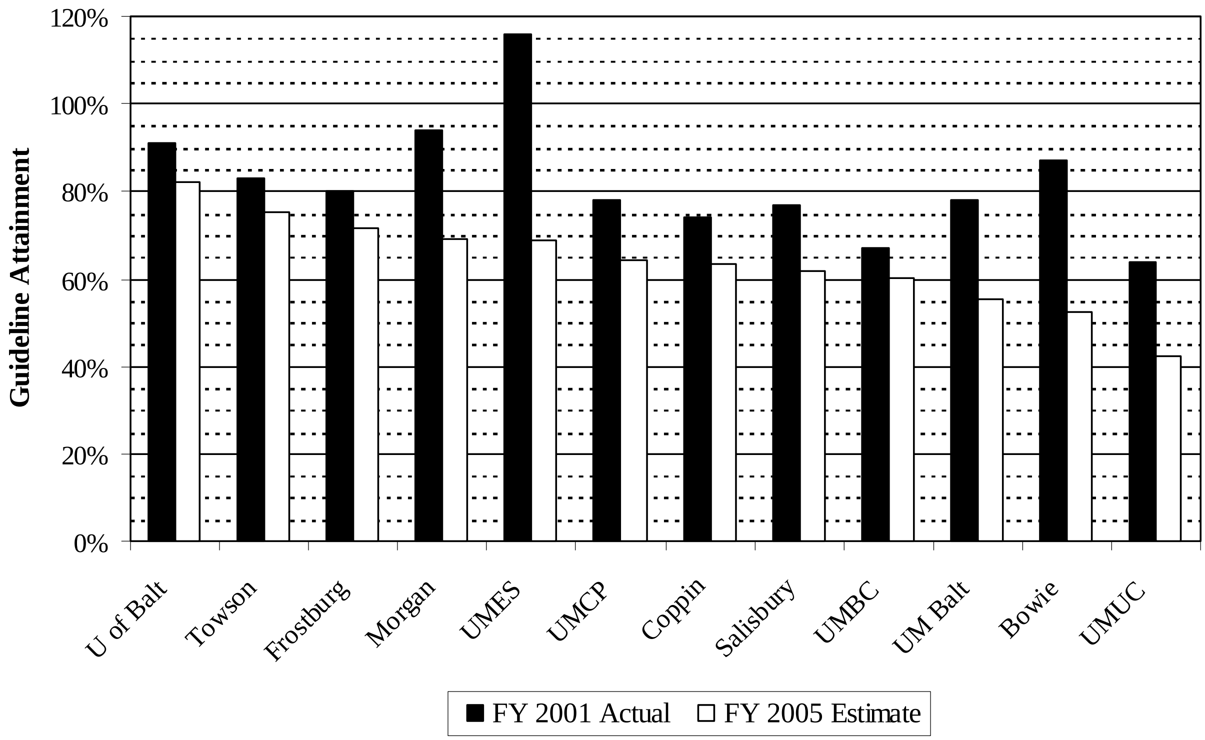
Exhibit 1
Annual Tuition and Mandatory Fees at USM Institutions
For Full-time Resident Undergraduate Students
Fall 2002 to 2004

University	Fall 2002	Fall 2003	Increase 02 to 03	Proposed Fall 2004	Increase 03 to 04
Bowie State	$4,064	$4,853	19.4%	$5,218	7.5%
Coppin State	3,959	4,240	7.1%	4,454	5.0%
Frostburg State	4,618	5,342	15.7%	5,830	9.1%
Salisbury	4,804	5,564	15.8%	5,976	7.4%
Towson	5,401	6,226	15.3%	6,672	7.2%
U of Baltimore	4,996	5,913	18.4%	6,448	9.0%
UM Baltimore*	5,096	6,224	22.1%	6,626	6.5%
UM Baltimore County	6,362	7,388	16.1%	8,020	8.6%
UM College Park	5,670	6,759	19.2%	7,426	9.9%
UM Eastern Shore	4,461	5,105	14.4%	5,558	8.9%
UM Univ College**	6,180	6,660	7.8%	6,780	1.8%
Morgan State	4,698	5,078	8.1%	5,578	9.8%

* Based on tuition and fees for the School of Nursing, the largest undergraduate program at UMB.
** Based on 30 credit hours per year.

Funding guidelines attempt to calculate an appropriate level of general fund support for Maryland's public institutions of higher education using per student spending at identified peer institutions. MHEC calculates the guidelines and, accounting for different tuition rates at the peer institutions, calculates a recommended State appropriation for each institution. **Exhibit 2** shows that estimated funding guideline attainment for fiscal 2005 is below actual fiscal 2001 attainment for every institution.

Exhibit 2
Funding Guideline Attainment
Fiscal 2001 and 2005



Source: Maryland Higher Education Commission

State Revenues: Two revenue sources would be affected by the bill. The surcharge on corporate income taxes would establish a revenue source for HEIF. In addition, assuming the bill's funding requirements are met, tuition and fees at USM institutions and MSU would be limited to 5% annual increases, reducing potential tuition and fee revenues.

Surcharge on Corporate Income Taxes

The corporate income tax surcharge would be imposed from calendar 2004 through 2007. The surcharge would increase revenues by an estimated $79.8 million in fiscal 2005 when, in effect, six quarterly payments would be made, including four in the first half of the fiscal year (to account for all of calendar 2004) and two in the last half of the fiscal year (to account for the first half of calendar 2005). In fiscal 2006 and 2007, estimated annualized revenues of $60.4 million and $66.3 million, respectively, would be collected from the surcharge. In fiscal 2008, when only half a year of revenues would be generated, collections are estimated at $34.4 million. All of the proceeds from the surcharge would be placed into HEIF.

Tuition and Fee Reductions

Assuming the supplementary appropriations specified in the bill are granted, tuition and mandatory fees for resident undergraduate students attending USM institutions and MSU would be limited to 5% increases over fiscal 2004 tuition and fee rates. This would decrease tuition and fee revenues by an estimated $13.3 million in fiscal 2005. This estimate assumes that proposed fiscal 2005 increases in tuition and fees for resident undergraduate students would take place without this legislation. The proposed increases range from 1.8% at University of Maryland University College to 9.9% at the University of Maryland, College Park.

From fiscal 2006 to 2008, annual tuition growth for resident undergraduates would be limited to 5% per year. USM advises that resident undergraduate tuition and fee rates will increase by approximately 6% annually after fiscal 2005 if the rates are not restricted. Tuition and fee revenues under the bill would be an estimated $31.4 million below planned tuition and fee revenues by fiscal 2008.

After tuition and fee limitations have been lifted, in fiscal 2009, it is assumed that tuition and fees would increase by 6%. **Exhibit 3** shows the estimated annual impact of the tuition and fee limitations that would be imposed by the bill.

Exhibit 3
Impact of Resident Undergraduate Tuition and Fee Limitations
Fiscal 2005 to 2009
($ in millions)

	FY 2005	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**
USM Revenues					
SB 770	$401.8	$429.3	$457.5	$488.1	$527.2
Current Estimates	413.8	446.3	480.0	516.9	558.1
Impact	($12.0)	($16.9)	($22.5)	($28.8)	($31.0)
MSU Revenues					
SB 770	$27.4	$29.9	$31.9	$34.2	$36.6
Current Estimates	28.7	31.6	34.0	36.8	39.4
Impact	($1.3)	($1.7)	($2.1)	($2.6)	($2.8)
T&F Revenues	**($13.3)**	**($18.6)**	**($24.6)**	**($31.4)**	**($33.8)**

The bill also limits the number of out-of-state undergraduate students at USM institutions to 30% of the total undergraduate student population. Since out-of-state students pay higher tuition rates, this provision could also limit tuition revenues. According to data from MHEC, however, no USM institution currently has an undergraduate residency rate less than 74%. The requirement would limit the ability of USM institutions to increase revenues by accepting more out-of-state students but would not further reduce tuition and fee revenues.

The bill requires USM institutions to establish a tuition level for out-of-state students that is equal to the cost of educating the student, including the costs of facility renewal, equipment for new facilities, academic revenue bond debt expenses, and other expenses related to building and operating State-supported facilities. This would increase tuition for out-of-state students and increase USM tuition revenues. However, USM is in the process of making this change without legislation, so the bill would not impact out-of-state tuition levels.

State Expenditures: The bill provides supplementary fiscal 2005 appropriations for USM and MSU and mandates annual increases of at least 5% for USM and MSU from fiscal 2006 to 2008. The required annual appropriations, which would be paid with general funds and HEIF, are shown in **Exhibit 4**.

Exhibit 4
Required Annual Appropriations to USM and MSU
Fiscal 2005 to 2008
($ in millions)

	USM	MSU
Proposed Fiscal 2005 Appropriation	$747.3	$48.2
Supplementary Appropriation	25.4	1.6
Fiscal 2005 Total	$772.7	$49.8
Fiscal 2006 Total (+5%)	$811.3	$52.3
Fiscal 2007 Total (+5%)	$851.9	$54.9
Fiscal 2008 Total (+5%)	$894.5	$57.6

Higher Education Investment Fund Expenditures

HEIF expenditures would increase by $27 million in fiscal 2005 to provide the supplementary appropriations specified in the bill. In future years, HEIF would support up to 3% of the required growth (3% out of the 5% growth, or 60% of total growth) in State funding for USM and MSU. HEIF expenditure estimates are shown in **Exhibit 5**, along with estimates of the annual revenues and the balance that would be carried forward each year. It is assumed that, in addition to funding a portion of the cumulative increase in appropriations each year, HEIF would continue to provide the base $27 million ($25.4 million for USM and $1.6 million for MSU) increase that would be provided in fiscal 2005.

Exhibit 5
The Higher Education Investment Fund
Fiscal 2004 to 2008
($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008
New Revenues	$79.8	$60.4	$66.3	$34.4
Balance Carried Forward	0.0	52.8	61.5	50.2
Maximum Expenditures	$27.0	$51.7	$77.6	$104.8
Actual Expenditures	27.0	51.7	77.6	84.7
Balance	$52.8	$61.5	$50.2	$0.0

As shown in the exhibit, HEIF revenues are projected to expire before making the maximum allocation in fiscal 2008. It is assumed that general funds would support any portion of the required increase that is not funded by HEIF.

General Fund Appropriations

HEIF is limited to supporting 3% growth in State appropriations to USM and MSU from fiscal 2006 to 2008, and the remainder of the growth, 2% per year, must come from general funds. Assuming general fund appropriations would not increase beyond the level required by the bill, the estimated annual increases in general fund appropriations under the bill would be outpaced by current projections of increases in general fund appropriations. Current projections show increases in general fund appropriations for USM and MSU of approximately 4% per year. In effect, funding from HEIF would supplant a portion of projected general fund expenditures, resulting in an estimated general fund savings for fiscal 2006 to 2008.

In fiscal 2009, it is assumed that general fund support for USM and MSU would increase off the higher base funding levels established from fiscal 2005 to 2008. The estimated general fund impact for fiscal 2006 to 2009 is shown in **Exhibit 6**.

Exhibit 6
General Fund Impact
Fiscal 2006 to 2009
($ in millions)

	FY 2006	FY 2007	FY 2008	FY 2009
SB 770	$811.9	$829.2	$867.5	$992.7
Current Estimates	830.1	865.4	902.4	940.8
Impact	(18.1)	($36.1)	($34.9)	$51.8

The combined impact of increased HEIF funding and general fund support, as compared to projected current law general fund appropriations for USM and MSU, is shown in **Exhibit 7**.

Exhibit 7
Estimated State Funding Increases
Fiscal 2005 to 2009
($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
USM Appropriations					
State Funding (GF+HEIF)	$772.7	$811.3	$851.9	$894.5	$932.2
Current Estimates (GF)	747.3	779.1	810.9	844.9	880.5
Impact	$25.4	$32.3	$41.1	$49.6	$51.7
MSU Appropriation					
State Funding (GF+HEIF)	$49.8	$52.3	$54.9	$57.6	$60.5
Current Estimates (GF)	48.2	51.0	54.5	57.5	60.4
Impact	$1.6	$1.3	$0.4	$0.1	$0.1
State Funding Increase	**$27.0**	**$33.5**	**$41.4**	**$49.8**	**$51.8**

Impact on Sellinger, Cade, and BCCC formulas

Formulas supporting private colleges and universities, locally-operated community colleges, and Baltimore City Community College (BCCC) are based on State general fund support for public four-year institutions of higher education. If State general fund support decelerates as assumed in this fiscal note, funding for the Sellinger formula (for private colleges and universities), the Senator John A. Cade funding formula (for community colleges), and BCCC could also be affected. The formulas are based on State support in the prior fiscal year, so there would be no impact on the formulas until fiscal 2007.

Aggregate Fiscal Effect on USM and MSU: Overall revenues for USM, including the tuition and fee revenue reduction and the State funding increase, would increase by an estimated $13.4 million in fiscal 2005 and an estimated $20.7 million in fiscal 2009. For MSU, overall fiscal 2005 revenues would increase by an estimated $336,000. However, in fiscal 2006 to 2009 the effect of the 5% tuition limitation on MSU relative to a projected 6% increase would more than offset the additional State funding mandated under the legislation. The estimated combined net impacts on USM and MSU are shown in **Exhibit 8**.

Exhibit 8
Net Impact of Increased State Funding and Decreased Tuition Revenues
Fiscal 2005 to 2009
($ in millions)

	FY 2005	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**
USM					
State Funding Increase	$25.4	$32.3	$41.1	$49.6	$51.7
Tuition and Fees Decrease	(12.0)	(16.9)	(22.5)	(28.8)	(31.0)
Net Impact	$13.4	$15.3	$18.6	$20.8	$20.7
MSU					
State Funding Increase	$1.6	$1.3	$0.4	$0.1	$0.1
Tuition and Fees Decrease	(1.3)	(1.7)	(2.1)	(2.6)	(2.8)
Net Impact	$0.3	($0.4)	($1.7)	($2.5)	($2.6)
Total Net	**$13.7**	**$14.9**	**$16.9**	**$18.4**	**$18.1**

Additional Information

Prior Introductions: None.

Cross File: HB 1188 (Delegate Jones, *et al.*) – Appropriations and Ways and Means.

Information Source(s): Maryland Higher Education Commission, University System of Maryland, Department of Legislative Services

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