SB 232

Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE
Revised

Senate Bill 232 (The President, *et al.*)
(Administration)
Budget & Taxation and Economic & Environmental Affairs Ref. to Appropriations

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Higher Education - Maryland Higher Education Investment Program

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This enrolled Administration bill establishes a Maryland Higher Education Investment Program as a means to pay for the cost of tuition in advance of enrollment at an institution of higher education in Maryland. It establishes a seven-member Maryland Higher Education Investment Program Board to administer the program. The board is required to (1) adopt a comprehensive investment plan for the administration of the program; (2) make every effort to invest program assets in a manner that earns, at a minimum, sufficient earnings to generate the difference between the prepaid amount under advance payment contracts and the average in-State tuition costs at public institutions of higher education in Maryland at the time of enrollment; (3) annually review the comprehensive investment plan to assure that the program remains actuarially sound; and (4) adjust the terms of subsequent higher education investment contracts to ensure continued actuarial soundness or, if necessary, adjust the terms of current higher education investment contracts. The board may (1) employ additional staff in accordance with the State budget; (2) retain the services of consultants; and (3) collect reasonable administrative fees (subject to the review of the General Assembly). The Governor is required to include an appropriation for program administrative and start-up costs in the fiscal 1998 State budget. The debts of the program are not debts of the State. Moneys of the program are not moneys of the State and may not be deposited in the State Treasury.

The bill takes effect on July 1, 1997.

Fiscal Summary

State Effect: General funds of $827,200 are included in the FY 1988 budget on a one-time basis for establishing the board, contingent upon enactment of this bill. General funds for an additional auditor position will increase by $47,500 in FY 2000; the costs for the position will be reimbursed by the board. General fund revenues could decrease by an indeterminate amount.

Local Effect: Indeterminate revenue decrease based on extent of State tax revenue decrease. Expenditures would not be affected.

Small Business Effect: The Administration has determined that this bill has minimal or no effect on small businesses (attached). The Department of Fiscal Services concurs with this assessment as discussed below. (The attached assessment does not reflect amendments to the bill.)

Fiscal Analysis

Bill Summary: The board is to establish a program of higher education investment contracts to be known as (1) the community college plan; (2) the university plan; and (3) the two plus two plan (two years at a community college plus two years at a four-year institution). The cost of a higher education investment contract is to be based on (1) the average current in-State tuition costs at the time the contract is purchased at public institutions of higher education in the State; (2) the number of years expected to elapse between the purchase of a higher education investment contract and the use of the benefits of the contract; and (3) the projected tuition costs at the time that the benefits will be exercised.

The assets and income of the program are exempt from State and local taxation. The board is required to solicit an opinion letter from the United States Securities Exchange Commission concerning the application of federal security laws to the program.

State agencies and local governments may agree to remit payments on behalf of an employee toward a higher education investment contract through payroll deductions. The Legislative Auditor is required to audit the program annually. The board is to pay for the audit.

The board's budget is subject to review by the General Assembly for information purposes only. Staff hired by the board are subject to the provisions of the State Personnel and Pensions Article. The bill establishes the fiduciary responsibilities of the board and certain program employees. Program fiduciaries must be bonded.

The board is required to submit a report on the Maryland Higher Education Investment Program to the Governor and General Assembly within 90 days after the close of each fiscal year. The report is to include a description of the financial condition of the program as well as an update on the program's assets and liabilities.

Maryland Higher Education Investment Program funds consist of (1) payments from higher education investment contracts; (2) bequests, endowments, or funds from other private sources; (3) interest and income earned from program investments; and (4) federal, State, or local funds.

Unless the board provides otherwise by regulation, it is required to use the proceeds of the program in the following order (1) to pay eligible institutions of higher education in accordance with the board's obligations under advance payment contracts; (2) to refund money on the termination of advance payment contracts; and (3) to pay the operating costs of the board.

Background: The General Assembly has expressed concern that higher education tuition and fees have been increasing faster than median family income and the Consumer Price Index and that grant and scholarship awards have been reduced, causing families to go into debt to finance a college education. Chapter 89 of the Acts of 1996 (SB 8) established a Task Force on the Maryland Higher Education Investment Savings Program to develop an implementation plan for the advance payment of undergraduate tuition at higher education institutions in Maryland. The task force's December 1996 report calls for (1) creation of an independent, off-budget agency within the Executive Department to administer a higher education investment program; (2) January 1998 as the target date to begin offering contracts; (3) an investment strategy consistent with guidelines established for the Maryland State Retirement and Pension System, which would allow investment in stocks as well as fixed income securities; (4) a guarantee backed by the assets of the program rather than the full faith and credit of the State; and (5) inclusion of two-year and four-year public institutions as well as private institutions as participating higher education institutions.

The federal Small Business Job Protection Act of 1996 (HR 3448) contains provisions that clarified the federal tax status of state-sponsored higher education investment programs and that of purchasers and beneficiaries. As a result of the new federal law, a qualified State higher education investment program will not have to pay federal taxes on its investment earnings. In addition, funds invested in a higher education investment program will not be taxed until benefits are used by the beneficiary.

State Revenues: General fund revenues could decrease by an indeterminate amount to the extent that monies are transferred from other taxable investments into higher education investment contracts. It is not possible to reliably predict at this time the extent to which funds used to purchase higher education investment contracts would come from taxable investments.

State Expenditures: The fiscal 1998 budget includes $827,243 in start-up funds for the

Maryland Higher Education Investment Program, which reflects a 90-day start-up delay. The funds will be used (1) to hire seven positions for program administration [three permanent positions (one Executive Director, one Program Manager, and one Administrative Aid) and four contractual Program Specialists]; and (2) marketing and actuarial services. The $827,243 budget includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	$122,417
Contractual employees (4)	88,016
Contractual actuarial/tax services	250,000
Contractual marketing services	150,000
Postage (500,000 brochures)	160,000
Other Operating Expenses	56,810
Total FY 1998 State Expenditures	**$827,243**

Although start-up funds have been included in the Maryland Higher Education Commission's fiscal 1998 budget, the task force anticipated that a separate off-budget agency would actually administer the program. The task force's intent is that the program be self-supporting once the State provides the initial "seed" funding. To cover the administrative costs of the program after fiscal 1998, administrative fees paid by contributors would be deposited into an administrative fund, separate from contract payments. The Department of Fiscal Services advises that although the bill requires that the Governor include funds in the fiscal 1998 State budget to provide start-up costs for the program, nothing in the bill precludes the possibility of additional State funds in future years to support administration of the program.

The Maryland Higher Education Investment Program would be subject to an audit each year by the Legislative Auditor. Due to the bill's requirement of an annual audit, an additional auditor position would be needed and general fund expenditures could increase by an estimated $47,500 in fiscal 2000. This estimate assumes that the program would (1) have sound fiscal policies and procedures; (2) be located in the Baltimore-Annapolis area so that overnight travel would not be required; (3) be subject to an annual financial audit; and (4) be subject to a biennial fiscal/compliance audit. The bill specifies that the board is to pay for the audit. The office would bill the board for the audit and submit the collections into the State general fund.

Maryland Higher Education Investment Program Revenues and Expenditures: Revenues accruing to the program from higher education investment contracts could total $69.4 million in the first year of program operation, which covers the second half of fiscal 1998 and first half of fiscal 1999. Therefore, fiscal 1998 revenues could be an estimated $13.8 million, assuming that 20% of first-year revenues accrue in fiscal 1998.

The consulting firm Deloite and Touche LLP developed for the task force an estimate of contract prices based on Florida's 1997 contract prices adjusted for the difference in the weighted average tuition between Maryland and Florida. Their estimate assumes (1) interest rates of 7.5% per year until matriculation and 8% thereafter; (2) tuition increases based on historical experience; and (3) no significant changes in relative enrollments between institutions. The weighted average tuition for fiscal 1997 is $3,969 for four-year institutions and $2,118 for community colleges.

An estimated 10,000 contracts would be issued annually, based on (1) a target population of 1.1 million children less than 17 and not in poverty; and (2) a participation rate of 0.85% based on an affordability factor (average tuition divided by median family income). Contracts are assumed to be distributed between the three types of plans as shown below in **Exhibit 1**.

Exhibit 1
Projected Number of Annual Higher Education Investment Contracts

Plan Type	Annual Number of Contracts	Percent Making Lump Sum Payment	Percent Making Monthly Payments
Four-year	6,000	60%	40%
Two plus two	2,000	40%	60%
Two-year	2,000	10%	90%

The number of contracts can be multiplied by the contract price to get an estimate of average annual program revenues. For illustrative purposes, Attachment 1 is an estimate of program revenues, using an average contract price for children from birth through ninth grade. **Exhibit 2** shows the total annual revenues and administrative fees from Attachment 1, converted to fiscal years.

Exhibit 2
Projected Maryland Higher Education Investment Program Revenues and Administrative Expenditures

(in millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Revenues	$13.8	$72.9	$80.1	$88.1	$96.9
Administrative Expenditures	$0	$2.3	$2.5	$2.6	$2.8

Future year expenditures assume an annual investment advisor fee of 1.5% of contract revenues ($1.4 million in fiscal 1999). Future year revenues assume a 10% increase in contract price each year.

Local Revenues: The bill stipulates that the assets and income of the program are not taxable by State and local government. As a result, local governments would lose 54.5% of any State revenues lost.

Local Expenditures: The bill requires that local governments provide for payroll deductions for employees purchasing higher education investment contracts. It is assumed that the function of payroll deduction and distributing monies to the program could be handled with existing budgeted resources.

Small Business Effect: Establishment of a Maryland Higher Education Investment Program could benefit small businesses to the extent that the program retains the services of small business consultants.

Information Source(s): Maryland Higher Education Commission; St. Mary's College; University of Maryland System Administration; State Treasurer's Office; Comptroller of the Treasury; Morgan State University; Department of Fiscal Services; *Task Force on Maryland Prepaid Tuition Savings Program,* December 1996

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