

Department of Legislative Services
 Maryland General Assembly
 2017 Session

FISCAL AND POLICY NOTE
Third Reader

House Bill 437
 Appropriations

(Delegate Jones)

Budget and Taxation

Higher Education - University System of Maryland - Quasi-Endowment Funds

This bill authorizes the Board of Regents of the University System of Maryland (USM) to make a one-time transfer of no more than \$50.0 million from the State-supported fund balance to the quasi-endowment fund. The board may use the investment proceeds for facility renewal projects relating only to capital facilities used for State-supported activities.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: Assuming the authorized one-time transfer is made in FY 2018, the USM fund balance decreases by an estimated \$50.0 million, with a commensurate increase in quasi-endowment funds to be invested. Beginning in FY 2019, higher education revenues and expenditures increase by an estimated \$1.4 million annually due to quasi-endowment funds earning higher rates of return than the State Treasurer’s Office. However, investment returns may be significantly lower or higher due to market risks, and the State’s return may vary annually. In addition, the principal amount may be lost due to market risks. Any investment proceeds must be used for facility renewal projects relating only to capital facilities used for State-supported activities.

(\$ in millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Higher Ed Rev.	\$0	\$1.4	\$1.4	\$1.4	\$1.4
Higher Ed Exp.	\$50.0	\$0	\$0	\$0	\$0
Net Effect	(\$50.0)	\$1.4	\$1.4	\$1.4	\$1.4

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

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: Chapter 266 of 2013 authorized the Board of Regents of USM to establish a quasi-endowment fund and authorized the board to make a one-time-only transfer of no more than \$50.0 million from the *non*-State-supported fund balance held and invested by the State Treasurer to the quasi-endowment fund.

The Board of Regents of USM is authorized to maintain and manage gift and endowment funds. The board must submit an annual investment performance report on its gifts and endowments by November 1.

State agencies are generally required to maintain all cash and investments with the State Treasurer, who invests and manages the funds. The governing boards of Morgan State University and St. Mary's College of Maryland are also authorized to maintain and manage gift and endowment funds outside the State Treasurer's Office.

Background: A quasi-endowment is a fund or an investment established by the governing board of an organization with the expectation that the monies be invested and managed to last in perpetuity; in general, the governing board may decide at any time to expend the principal. Institutions with quasi-endowments generally invest the funds like they would their endowment funds, which are restricted by external donors so that the principal cannot be spent within a certain time period or in perpetuity but dip into the principal to provide cash flow for operations or projects during difficult financial periods or when funds are needed for a particular project.

According to the USM Financial Statement for the year ending June 30, 2016, USM had \$2.121 billion in cash and short-term investments on deposit with the State Treasurer. The State Treasurer's Office advises that the average rate of return on its short-term investments is 1.37% as of January 2017.

As authorized, USM established the quasi-endowment fund at the end of fiscal 2014 with a one-time \$50.0 million transfer from the non-State-supported portion of its fund balance: \$40.0 million from the institutions and \$10.0 million from the University System of Maryland Office (USMO). These funds were then transferred to the USM Foundation for investment. USM estimated that a \$50.0 million quasi-endowment would generate \$2.1 million annually (based on a return of 4.25%), which would be used to enhance the funding for development and fundraising operations. Each institution's contribution to the fund was based on the size of its budget relative to USM's total budget, with the distribution of the estimated \$1.7 million annual spendable income also proportionate to the

contributions. The \$10.0 million contributed by USMO is projected to have an annual return of \$425,000, which will be allocated to institutions based on a competitive grant process. The institutions are required to annually report to the Board of Regents Committee on Advancement on the use of and results from using the funds. Further details on the quasi-endowment fund, including the institutions' shares and fiscal 2016 grants can be found in the Department of Legislative Services' [Analysis of the FY 2017 Maryland Executive Budget, 2016](#).

The USM fund balance totals an estimated \$997.1 million at the end of fiscal 2016, including \$233.0 million in State-supported funds. That amount is anticipated to grow to \$256.7 million at the end of fiscal 2017.

State Fiscal Effect: USM did not provide any details on any plans for funds to be allocated to the quasi-endowment fund under the bill. Assuming the Board of Regents of USM makes the one-time transfer in fiscal 2018, the USM fund balance decreases by an estimated \$50.0 million, with a commensurate increase in quasi-endowment funds to be invested. Beginning in fiscal 2019, higher education revenues and expenditures increase by an estimated \$1.4 million annually due to quasi-endowment funds earning higher rates of return (based on an expected rate of return of 4.25%). This is less than USM's long-term target return of over 7%, which would result in a significantly higher return. However, investment returns may be significantly lower due to market risks; for example, in fiscal 2016, the quasi-endowment fund reported a loss of 1.8%.

This estimate is based on the assumption that Treasurer-held investments are making approximately 1.37% annually or approximately \$685,000 per \$50.0 million while the USM Foundation-held investments are making approximately 4.25% or approximately \$2.1 million per \$50.0 million. Thus, under the bill, an estimated \$1.4 million annually will be available for facility renewal projects relating only to capital facilities used for State-supported activities. However, investment returns may be significantly lower or higher due to market risks, and the rate of return on Treasurer-held investments may vary. In addition, the principal amount may be lost due to market risks. Any investment proceeds must be used for facility renewal projects relating only to capital facilities used for State-supported activities.

Additional Information

Prior Introductions: SB 583 of 2016 passed the Senate and received a hearing in the House Appropriations Committee, but no further action was taken.

Cross File: SB 202 (Senator King, *et al.*) - Budget and Taxation.

Information Source(s): University System of Maryland; Treasurer's Office; Department of Legislative Services

Fiscal Note History: First Reader - February 6, 2017
md/rhh Third Reader - April 6, 2017

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