

Department of Legislative Services
Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 871

Appropriations

(Delegate Jones, *et al.*)

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 \$25.0 million from the *non*-State-supported fund balance to the quasi-endowment fund. The board may use the investment proceeds only to match a privately funded scholarship program at the University of Maryland, College Park Campus (UMCP). The bill expresses legislative intent that the USM Board of Regents make the transfer from UMCP's fund balance. **The bill takes effect July 1, 2018.**

Fiscal Summary

State Effect: Assuming the authorized one-time transfer is made in FY 2019, the USM fund balance decreases by an estimated \$25.0 million, with a commensurate increase in quasi-endowment funds to be invested. Beginning in FY 2020, higher education revenues may increase due to the quasi-endowment funds earning higher rates of return; higher education expenditures may also increase as soon as FY 2020 for a portion of the funds to be used to match private donations, as explained below. 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.

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.

Chapters 741 and 742 of 2017 authorized the Board of Regents of USM to make a one-time-only transfer of no more than \$50.0 million from the State-supported fund balance held and invested by the State Treasurer to the quasi-endowment fund to be used only for facility renewal projects at capital facilities used for State-supported activities.

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.

The non-State-supported portion of the fund balance consists of funds from self-supporting sources, including dining hall fees, athletic fees, and other student fees. One of the uses of the non-State-supported fund balance is for facilities renewal of self-supporting facilities and activities.

USM has a policy on endowment funding spending rules that says that, annually, spending from a quasi-endowment fund is to be 4.25% of the average market value over the past three years. However, this policy may be changed.

According to the USM Financial Statement for the year ending June 30, 2017, USM had \$2.125 billion in cash and short-term investments on deposit with the State Treasurer. The State Treasurer's Office advised in January 2017 that the average rate of return on its short-term investments was 1.37%.

As authorized by Chapter 266, 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' (DLS) [Analysis of the FY 2017 Maryland Executive Budget, 2016](#).

USM has not yet made the transfer from the State-supported fund authorized by Chapters 741 and 742 of 2017. However, there is a plan to transfer \$10.0 million to the facilities renewal quasi-endowment fund.

The USM fund balance is anticipated to total an estimated \$1.085 billion at the end of fiscal 2018, including \$853.0 million in non-State-supported funds. That amount is anticipated to grow to \$873.4 million at the end of fiscal 2019. Further details on the fund balance, including institutions' shares, can be found in DLS' [Analysis of the FY 2019 Maryland Executive Budget, 2018](#). UMCP is anticipated to have \$257.7 million in its non-State-supported fund balance at the end of fiscal 2018.

Need-based Financial Aid

For the 2017-2018 academic year, the maximum federal Pell grant for the most financially needy students is \$5,920 and the minimum is \$596. The Pell grant amount depends on the cost of attendance (including tuition and fees, room and board, books, etc.) at the institution and the expected family contribution, which results in a student's financial need. The State also provides financial assistance to students, totaling \$106.4 million in the fiscal 2018 budget. Most of the aid is distributed based on financial need through the Delegate Howard P. Rawlings Educational Excellence Awards program (EEA). Students receiving Pell grants are also eligible for State financial aid, such as EEA.

The A. James & Alice B. Clark Foundation Donation

The A. James & Alice B. Clark Foundation announced a donation of \$219.5 million to UMCP in October 2017, for a number of initiatives. A. James Clark, who died in March 2015, graduated from UMCP in 1950 with a civil engineering degree and became a

major figure in construction and development. According to the *Washington Post*, with its gift, UMCP plans three financial aid initiatives: the “Clark Challenge for Maryland Promise” to help the university raise money through matching funds to support need-based scholarships for a wide spectrum of students; scholarships for 40 engineering undergraduates a year with priority for in-state students; and 40 scholarships a year for engineering majors who transfer from Maryland community colleges. Funds will also be used to endow eight distinguished chairs in engineering and five leadership chairs in interdisciplinary fields. Finally, the gift will support construction of a new engineering building and expansion of another as well as engineering fellowships.

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 makes the one-time transfer in fiscal 2019, the USM fund balance decreases by an estimated \$25.0 million, with a commensurate increase in quasi-endowment funds to be invested. Beginning in fiscal 2020, higher education revenues increase by an estimated \$1.4 million annually due to quasi-endowment funds earning higher rates of return. This estimate is based on the assumption that Treasurer-held investments are making approximately 1.37% annually or approximately \$342,500 per \$25.0 million while the USM Foundation-held investments are making approximately 7% or approximately \$1.75 million per \$25.0 million.

However, investment returns may be significantly lower or higher due to the market, as they have been over the past two years. In fiscal 2016, the quasi-endowment fund reported a loss of 1.8%. For calendar 2017, USM reports investment returns of 12.7%. In addition, the principal amount may be lost due to market risks.

On the expenditure side, this estimate assumes that USM’s policy of 4.25% of the rolling three-year average value of the fund is used for the purposes of the bill. Thus, approximately \$1.1 million will be available beginning in fiscal 2020 to match a privately funded scholarship program at UMCP. This estimate reflects investment returns as discussed above and ongoing spending of 4.25% of the fund’s value annually. Over time, assuming continuing investment returns and spending at the assumed rates, annual revenues and expenditures increase incrementally. If these funds are matched one-to-one with private funds, approximately \$2.2 million will be available annually for the scholarship beginning in fiscal 2020. It is assumed that the scholarship is managed by UMCP with existing funds.

Additional Information

Prior Introductions: None.

Cross File: Although designated as a cross file, SB 502 (Senators Smith and Miller - Budget and Taxation) is not identical.

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

Fiscal Note History: First Reader - February 18, 2018
nb/rhh Third Reader - March 16, 2018
Revised - Amendment(s) - March 16, 2018
Revised - Updated Information - March 16, 2018
Revised - Other - May 3, 2018

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