

RH.00
Maryland Prepaid College Trust

Operating Budget Data

(\$ in Thousands)

	FY 01	FY 02	FY 03		% Change
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>	<u>Prior Year</u>
Nonbudgeted Fund	\$1,751	\$1,786*	\$1,518	(\$268)	(15.0%)
Total Funds	\$1,751	\$1,786	\$1,518	(\$268)	(15.0%)

- The Governor's budget book does not accurately reflect the trust's current fiscal 2002 budget and as a consequence, nor does this chart. The trust's fiscal 2002 budget is \$1.607 million, and decreases by \$89,282 between fiscal 2002 and 2003.

* Fiscal 2002 figure differs from current spending plan.

Personnel Data

	FY 01	FY 02	FY 03	
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>
Regular Positions	6.50	6.50	9.50	3.00
Contractual FTEs	0.00	2.00	0.30	(1.70)
Total Personnel	6.50	8.50	9.80	1.30

Vacancy Data: Regular Positions

Budgeted Turnover: FY 03	0.11	1.19%
Positions Vacant as of 12/31/01	0.00	0.00%

- The trust's fiscal 2003 estimated budget includes two new accountants and one office clerk.

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

For further information contact: Brent Johnson

Phone: (410) 946-5530

Analysis in Brief

Issues

Trust Resumes Repayment of State Loan: For fiscal 2002, the trust intends to resume repayment of loans received from the State and has indicated its ability to make an additional repayment in fiscal 2003. **The trust is asked to brief the committees on its projected repayment schedule.**

New Legislation Clarifies Legislative Intent for College Investment Plan: Legislation has been introduced that would prohibit the Maryland Higher Education Investment Board (MHEIB) from allowing a purchaser to purchase more than one prepaid tuition contract or investment account per beneficiary in the same year. **The trust will be asked to comment on the impact of this new legislation, if enacted, on enrollment in the new College Investment Plan.**

Recommended Actions

1. Nonbudgeted.
2. Add language requiring the Maryland Prepaid College Trust to continue State loan repayments.

Updates

Prepaid Tuition Plan Investment Performance: The trust has experienced a negative yield on its prepaid tuition plan investments in fiscal 2001.

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Operating Budget Analysis

Program Description

The Maryland Prepaid College Trust is an independent State agency established by the Governor and the Maryland General Assembly in 1997 (Maryland Annotated Code Article 18, Section 18-1901 through 18-1916 and 18-19A-01 through 18-19A-07). The agency serves the Maryland Higher Education Investment Board (MHEIB), a nine-member body created under Article 18. Four board members serve by virtue of the State office they hold, including the State Treasurer, the State Comptroller, the Secretary of the Maryland Higher Education Commission, and the State Superintendent of Schools. The Governor appoints the five remaining members of the Board.

The board administers the Maryland Prepaid College Trust (MPCT) and oversees the administration of the Maryland College Investment Plan (MCIP). Participation in MPCT began in spring 1998; the trust's fifth enrollment period is set to begin December 2001. MPCT 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. Even those who live out-of-state but apply for a child that is a Maryland or District of Columbia resident are eligible. The purchaser chooses the number of years of tuition and mandatory fees that they wish to buy and how they wish to pay – single payment, monthly or annual payments. 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 federal and State tax incentives and a legislative guarantee.

MCIP became available for enrollment in December 2001. The plan is managed by T. Rowe Price and provides families with a second savings option by allowing an individual to select from 10 different investment portfolios and determine the amount and frequency of the contributions to an account. Contributions plus investment earnings are available for eligible higher education expenses including tuition, mandatory fees, room and board, and other qualified expenses as defined by Section 529 of the Internal Revenue Code. The investment plan does have similar tax benefits to the prepaid college trust but is not guaranteed by the State; therefore, the individual takes on a greater risk in exchange for the possibility of a greater return.

Estimated Budget

Changes in the Fiscal 2002 Budget

As shown in **Exhibit 1**, the fiscal 2002 budget shown in the exhibit differs significantly from the fiscal 2002 budget reviewed by the budget committees last session. The trust's original fiscal 2002 budget totaled \$1.8 million; however, the trust's current budget approved by the MHEIB is \$1.6 million.

Exhibit 1

**Maryland Prepaid College Trust Nonbudgeted Revenue
Revised Fiscal 2002 Estimate Versus Original Fiscal 2002 Estimate**

	Estimated FY 2002 Original	Estimated FY 2002 Revised	FY 2002 Change	% Change	Estimated FY 2003
Application fees	\$720,000	\$668,250	(\$51,750)	-7.2%	\$639,000
Program contributions	733,737	773,737	40,000	5.5%	878,765
Actuarial reserve – License fee	332,000	165,060	(166,940)	-50.3%	0
Total Revenues	\$1,785,737	\$1,607,047	(\$178,690)	-10.0%	\$1,517,765

Source: Maryland Prepaid College Trust; Department of Legislative Services

The revised fiscal 2002 nonbudgeted revenue projection is based on a reduction in the actuarial reserve used to pay for the trust’s software license for its records administration system and a projected decrease in new contract application fees. Program contributions increase slightly in the revised budget. The trust’s contract with T. Rowe Price provides for the contractor to pay half of the software license payments in fiscal 2002 and each year thereafter. The revised fiscal 2002 budget projection is based on more accurate data available in the summer, based on the number of applications and contract payments processed at the end of the previous prepaid tuition plan enrollment period (December through March).

The revenue sources are described briefly below:

- **Application Fees:** Those applying to the prepaid program during the winter 2001/spring 2002 enrollment period must pay a \$90 fee.
- **Operating Fees from Contract Payments:** Contract prices include fees to cover the trust’s operating expenses. Therefore, a small percentage of every payment made by a contract holder is to be spent by the trust, while a vast majority of the payment is invested for tuition and mandatory fees of the beneficiary. An administrative fee of 2.5% was factored into the contract price.
- **Actuarial Reserve (investment surplus):** The trust had used this revenue source to support its fall 2000/winter 2001 marketing campaign and in fiscal 2002 to support part of the software license cost. The trust does not intend to draw down its reserve in fiscal 2003.

Changes between the Fiscal 2002 and 2003 Budgets

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The 2003 budget decreases by almost \$89,282, or about 5.6%. The most significant dollar reduction is for technical and special fees due to the conversion of contractual employees. The deletion of a loan repayment to the State represents another decrease in the fiscal 2003 estimated expenditures. The repayment of State loans is discussed in the first issue. The trust intends to resume loan repayment in fiscal 2002 as a result of budget language adopted by the General Assembly during the 2001 legislative session. Increases in personnel, marketing, maintenance, and communications offset the reductions in other areas of the budget.

Exhibit 2 compares the revised fiscal 2002 budget to the estimated fiscal 2003 budget.

Exhibit 2

Comparisons of Fiscal 2002 and 2003 Estimated Expenditures

	Estimated FY 2002 Budget as of Jan. 2002	Estimated FY 2003	Change	Percent Change
Salaries and wages	\$452,429	\$609,773	\$157,344	34.8%
Technical and special fees	120,000	5,000	(115,000)	-95.8%
Fiscal services	129,000	139,000	10,000	7.8%
Marketing	309,753	318,750	8,997	2.9%
Maintenance/fixed charges	48,789	51,289	2,500	5.1%
Communication	127,502	129,050	1,548	1.2%
Supplies	24,200	25,000	800	3.3%
Other expenses	47,731	50,686	2,956	6.2%
Travel	15,000	15,000	0	0.0%
Loan repayment	100,000	0	(100,000)	-100.0%
Legal services	36,176	0	(36,176)	-100.0%
Software license	64,050	51,550	(12,500)	-19.5%
Consulting services/equipment for records administration	132,417	122,667	(9,750)	-7.4%
Total	\$1,607,047	\$1,517,765	(\$89,282)	-5.6%

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

Source: Maryland Prepaid College Trust; Department of Legislative Services

Performance Analysis: Managing for Results

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Exhibit 3 shows selected performance data from the trust's Managing for Results (MFR) submission. The measures focus on marketing activities and, to some extent, the effectiveness of those marketing efforts. The single goal under the trust's MFR submission is to create and maintain statewide awareness of the State's two college savings plans. Between fiscal 1999 and 2001, the number of enrollment kits distributed declined. The amount of direct mailings significantly declined in fiscal 2001 when compared to fiscal 2000 and 1999. This likely occurred because the trust's budget decreased during this time period. The trust is anticipating an increase in direct mailings in fiscal 2002 and 2003. This may be attributed to additional efforts to inform the public about the new College Investment Plan for which a person can apply for an account anytime during the year. The marketing of the second program might have contributed to the increase in paid television and radio spots in fiscal 2001. The College Investment Program began in early December; and by January 31, 2002, the program had an asset value of \$106 million with a total of 29,851 accounts established.

Exhibit 3

**Program Measurement Data
Maryland Prepaid College Trust
Fiscal 1999 through 2003**

	<u>Actual 1999</u>	<u>Actual 2000</u>	<u>Est. 2001</u>	<u>Actual 2001</u>	<u>Est. 2002</u>	<u>Est. 2003</u>	<u>Ann. Chg. 99-01</u>	<u>Ann. Chg. 01-03</u>
Enrollment kits (application books) distributed	55,000	50,000	36,300	40,375	50,000	50,000	-14.3%	11.3%
Paid television and radio spots	3,550	n/a	1,250	3,854	2,000	2,000	4.2%	-28.0%
Direct mailings	107,000	160,000	140,000	48,411	140,000	140,000	-32.7%	70.1%
Calls to toll-free number*	22,549	n/a	11,774	21,398	21,000	21,000	-2.6%	-0.9%
Web hits*	22,492	n/a	14,948	64,376	70,000	70,000	69.2%	4.3%
% of new application received online	n/a	n/a	n/a	31	35	35	n/a	6.3%
% of new applicants who attended public school presentations	n/a	n/a	15	14	18	18	n/a	13.4%

* Measures activity during enrollment periods only.

Note: Data for fiscal 2000 and 2001 only include statistics from Maryland Prepaid Tuition plan.

Source: Governor's Budget Book, Fiscal 2003

Although the number of calls made to the toll-free number has slightly declined in fiscal 2001 over fiscal 1999, the number of hits on the trust's web site increases substantially. This indicator can be linked

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the indicator that presents the percentage of new applications received online.

However as noted in last year's analysis, these indicators do not measure outcomes of the trust's marketing measures such as the number of applications received or the number of prepaid contracts (or investment accounts) sold. **The trust should add these indicators to its MFR submission.** Other measures that the trust should consider adding, include the percentage of Maryland and District of Columbia residents who purchase a prepaid contract or an investment account and the number of contracts or accounts purchased by lower income families. **Exhibit 4** shows the level of participation in the Maryland Prepaid College Trust program since 1998.

Exhibit 4

Participation in the Maryland Prepaid College Trust

<u>Enrollment Period</u>	<u>Applications</u>	<u>Contracts Purchased</u>
Spring 1998	1,356	1,102
Spring 1999	2,720	2,527
1999-2000	1,863	1,620
2000-2001	5,599	5,319
2001-2002	1,375*	n/a
Total	12,913	10,568

*As of February 22, 2002.

Source: Maryland Prepaid College Trust; Department of Legislative Services.

Issues

1. Trust Resumes Repayment of State Loan

From fiscal 1998 through 2001, the trust received start-up funding from the State in the form of grants (\$3.2 million) and loans (\$0.65 million). No additional State funding is planned for fiscal 2002 or 2003.

In fiscal 1999, the trust repaid \$30,000 of its loan from the State. The trust was allowed to delay additional repayments in fiscal 2000 and 2001 until it reached financial self-sufficiency. During the 2001 legislative session, the General Assembly added language requiring the trust to resume repayments in fiscal 2002. The trust plans to repay \$100,000 of the loan in fiscal 2002. The trust has not included a repayment in its estimated fiscal 2003 budget but has indicated that it can pay \$120,000 in delayed payments in fiscal 2003. The trust notes that its contract with T. Rowe Price requires the contractor to make one-half of the software license payments for a records administration system. According to the trust, these savings will allow the trust to make a repayment in fiscal 2003. However, the fiscal 2003 repayment proposal is not reflected in the estimated fiscal 2003 budget. **Exhibit 5** shows program and State funding for the trust between fiscal 1998 and 2001.

Exhibit 5

Program and State Support for the Maryland Prepaid College Trust Fiscal 1998 through 2001

	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>Total</u>
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	
Carryforward	\$0	\$280,686	\$446,083	\$219,343	
<u>Program Support</u>					
Application Fees/Other Fees	45,754	267,552	156,643	498,918	968,867
Operating Fees from Contract	0	0	0	881,895	881,895
Subtotal	\$45,754	\$267,552	\$156,643	\$1,380,813	\$1,850,762
<u>State Support</u>					
Grants	\$1,209,194	\$1,250,000	\$420,000	\$370,000	\$3,249,194
Loans	0	400,000*	250,000	0	650,000
Contingent Fund	0	40,000	0	0	40,000
State Support Subtotal	1,209,194	1,690,000	670,000	\$370,000	3,939,194
Total Revenues	\$1,254,948	\$2,238,238	\$1,272,726	\$1,970,156	\$6,736,068
Total Expenditures	\$974,262	\$1,792,155	\$1,116,383	\$1,750,813	\$5,633,613
Revenues Minus Expenditures	\$280,686	\$446,083	\$219,343**	\$219,343	

* A loan in the amount of \$150,000 was granted in fiscal 1998 and incorporated into the fiscal 1999 budget.

** Adjustment made in the amount of \$63,000 to fiscal 2000 budget. A limited number of receipts and disbursements are not captured in this table.

Note: Numbers do not necessarily match those presented in trust's audited financial statements.

Source: Maryland Prepaid College Trust; Department of Budget and Management; and Department of Legislative Services

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The trust should brief the committees on its projected repayment schedule including what funding the trust intends to use to make a payment in fiscal 2003 since a repayment is not reflected in the fiscal 2003 budget. The Department of Legislative Services recommends the addition of the following budget language:

Section XX. AND BE IT FURTHER ENACTED, That the General Assembly intends that Maryland Prepaid College Trust continue making its State loan repayments in fiscal 2003 and repayments be made in each year thereafter until the entire balance is repaid. The amount repaid in fiscal 2003 should be no less than \$120,000.

2. New Legislation Clarifies Legislative Intent for College Investment Plan

The new College Investment Plan accumulated close to \$100 million in investments after its first month of operation, with 27,612 accounts established for 13,477 beneficiaries as of December 31, 2001. The program allows an individual to make contributions to an account established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account at nearly any college nationwide. Qualified education expenses include tuition and fees, room and board, books, course-specific fees, and supplies. In contrast, the Prepaid College Trust, backed by a legislative guarantee, pays full in-state tuition at any Maryland public college or the weighted average tuition towards private or out-of-state colleges. The College Investment Plan is overseen by the MHEIB but is administered by T. Rowe Price.

Both plans also have federal tax benefits. New federal law now exempts federal taxes on earnings when benefits are paid to an eligible institution under both programs. Previously, a federal tax deferral was allowed as earnings accrued under a "qualified state tuition program" as defined under Section 529 of the Internal Revenue Code, but the tax was imposed on earnings when distributions were made from the plan. Both the investment plan and the prepaid college trust allow State residents to claim a subtraction modification (deduction) for contributions to a Maryland "529" plan. The maximum deduction cannot exceed \$2,500 per contract/account per year from the individual's Maryland State income. Both plans allow an individual to carry forward amounts contributed in excess of \$2,500 into subsequent years. The investment plan caps the ability to carry forward excess funds at ten years because a participant can contribute a larger sum of money in this program.

Under the investment plan, an individual can open up to ten accounts with ten different investment options for the same beneficiary. The trust has marketed this "multiple account" option that would allow an individual the ability to contribute up to \$2,500 for each of the ten accounts and receive a total deduction of \$25,000 for one taxable year. In December 2001, the Comptroller asked the General Assembly to clarify its intent in adopting this subtraction modification in the new investment program for tax years 2002 and thereafter. As of December 31, 2001, 3,991 individuals, or almost 30%, had more than one account for one beneficiary. Of that amount, 784 individuals, or almost 5%, opened 10 accounts for the same beneficiary. New legislation (Senate Bill 383 and House Bill 430) has been introduced to modify provisions in both college savings programs. The legislation makes the following modifications:

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- prohibits MHEIB from allowing the same purchaser or contributor to purchase multiple prepaid tuition contracts or open multiple investment accounts for a single beneficiary in the same year;
- authorizes the board to allow a purchaser or contributor to purchase multiple tuition plans under a single contract or to invest in multiple portfolios under a single investment account; and
- clarifies the application of income tax provisions relating to the College Savings Plans.

The trust will be asked to comment on the impact of this new legislation, if enacted, on enrollment in the new College Investment Plan.

Recommended Actions

1. Nonbudgeted.
2. Add the following language:

Section XX. AND BE IT FURTHER ENACTED, That the General Assembly intends that Maryland Prepaid College Trust continue making its State loan repayments in fiscal 2003 and repayments be made in each year thereafter until the entire balance is repaid. The amount repaid in fiscal 2003 should be no less than \$120,000.

Explanation: Between fiscal 1998 and 2000, the Maryland Prepaid College Trust received \$650,000 in interest-free State loans. In fiscal 2000, the trust repaid \$30,000. Language in the fiscal 2001 budget permitted the trust to delay its outstanding State loan payments until it was financially self-sufficient. Language in the fiscal 2002 budget required the trust to resume loan repayments as a result of anticipated additional revenues generated by enrollment exceeding participation levels in previous years. The trust has indicated it has the ability to make a payment of \$120,000 in fiscal 2003 because its contractor is required to pay half of the software license payments for a records administration system used for both the Prepaid College Trust and the new College Investment Plan.

Updates

1. Prepaid Tuition Plan Investment Performance

The trust has reported a negative return on investment of 8.5%, or a loss of approximately \$3.7 million in fiscal 2001 for its prepaid tuition plan. The reduction in assets is attributed to the trust's significant investment (currently around 63%) in the stock market, which experienced significant losses. The trust's 2001 annual report states the trust's goal to achieve a 7.65% return on investments. In developing its investment strategy, the trust takes into account future annual tuition increases of 5% and mandatory fee increases of 10%. The trust is reporting a return of 0.45% for the first six months of fiscal 2002. The MHEIB Chairman has proposed to limit stocks to 65% of the total prepaid tuition plan portfolio to allow for more conservative investments because children between fourth and seventh grade are making up the largest percentage of prepaid tuition enrollments. These older children will be drawing down funds earlier. Currently, the prepaid tuition plan can hold up to 80% in stocks.

Current and Prior Year Budgets

**Current and Prior Year Budgets
Maryland Prepaid College Trust
(\$ in Thousands)**

	<u>Nonbudgeted Fund</u>	<u>Total</u>
Fiscal 2001		
Estimated Budget	\$1,948	\$1,948
Change	22	22
Reversions and Cancellations*	(219)	(219)
Actual Expenditures	\$1,751	\$1,751
Fiscal 2002		
Estimated Budget	\$1,786	\$1,786
Change	(179)	(179)
Working Budget	\$1,607	\$1,607

* Carryforward funds

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

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Appendix 2

**Object/Fund Difference Report
Maryland Prepaid College Trust**

<u>Object/Fund</u>	<u>FY02</u>		<u>FY03</u> <u>Allowance</u>	<u>FY02 - FY03</u> <u>Amount Change</u>	<u>Percent</u> <u>Change</u>
	<u>FY01</u> <u>Actual</u>	<u>Working</u> <u>Appropriation</u>			
Positions					
01 Regular	6.50	6.50	9.50	3.00	46.2%
02 Contractual	0.00	2.00	0.30	(1.70)	(85.0%)
Total Positions	6.50	8.50	9.80	1.30	15.3%
Objects					
01 Salaries and Wages	\$ 435,418	\$ 433,887	\$ 609,773	\$ 175,886	40.5%
02 Technical & Spec Fees	95,042	148,611	5,000	(143,611)	(96.6%)
03 Communication	101,130	172,797	129,050	(43,747)	(25.3%)
04 Travel	11,128	15,000	15,000	0	0%
06 Fuel & Utilities	4,914	5,500	5,500	0	0%
07 Motor Vehicles	9,540	9,550	9,550	0	0%
08 Contractual Services	1,037,595	741,236	661,153	(80,083)	(10.8%)
09 Supplies & Materials	15,343	24,500	25,000	500	2.0%
11 Equip - Additional	2,364	111,667	16,000	(95,667)	(85.7%)
13 Fixed Charges	38,339	122,989	41,739	(81,250)	(66.1%)
Total Objects	\$ 1,750,813	\$ 1,785,737	\$ 1,517,765	(\$ 267,972)	(15.0%)
Funds					
07 Nonbudgeted Fund	\$ 1,750,813	\$ 1,785,737	\$ 1,517,765	(\$ 267,972)	(15.0%)
Total Funds	\$ 1,750,813	\$ 1,785,737	\$ 1,517,765	(\$ 267,972)	(15.0%)

Note: Full-time and contractual positions and salaries are reflected for operating budget programs only.