

Department of Legislative Services  
Maryland General Assembly  
2018 Session

FISCAL AND POLICY NOTE  
First Reader

Senate Bill 1049 (Senator Smith, *et al.*)

Education, Health, and Environmental Affairs  
and Budget and Taxation

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Higher Education - Endowed University System of Maryland Scholarship  
Program - Established

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This bill establishes the Endowed University System of Maryland Scholarship Program and Fund (fund) to eventually provide tuition-free education to undergraduate students at constituent institutions of the University System of Maryland (USM). Initially the program is for community college transfer students whose income is 125% or less of the most recently published federal Pell Grant maximum income level. To that end, the Board of Regents of USM is authorized to make a one-time transfer of no more than \$50.0 million from the *non*-State supported fund balance to the new quasi-endowment fund. **The bill takes effect July 1, 2018.**

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Fiscal Summary

**State Effect:** General fund expenditures increase annually to administer the scholarship. The USM fund balance decreases by *up to* \$50.0 million if fund balance is transferred, with a commensurate increase in the quasi-endowment/special fund to be invested. Special fund expenditures increase to the extent funds are available for scholarships.

**Local Effect:** None.

**Small Business Effect:** None.

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Analysis

**Bill Summary:** The scholarships are for income-eligible, full-time students that meet other specified eligibility criteria. Scholarships are on a first-come, first-served basis; however, priority for participating must be given to an undergraduate student who is transferring or

has transferred with an associate degree from a community college in the State. The Office of Student Financial Assistance within the Maryland Higher Education Commission (MHEC) must distribute money to constituent institutions of USM in a specified order. This is a last dollar scholarship. A student who continues to remain eligible to receive the award must continue to receive the award each year until the student receives a degree.

A recipient must maintain residence in the State for at least one year for each year that the scholarship was awarded. If a scholarship award recipient fails to maintain residency in the State, the funds must be converted from a scholarship award to a loan payable to the State. MHEC must administer any loans created. Any funds received from the repayment of loan must be paid to the fund.

The fund consists of funds from specified sources, including private donations. The Board of Regents of USM must invest the money in the fund in the same manner as other quasi-endowment funds, and interest must accrue to the fund. In general, only the interest from the fund may be used to make scholarships (by transferring the funds to MHEC) or be reinvested in the fund; the principal may be used if the interest earnings are insufficient to provide renewal scholarships. However, a constituent institution may withdraw from the fund an amount equivalent to the amount of principal attributable to the institution that was used to initially capitalize the fund multiplied by the interest rate earned on the non-State supported fund balance that is held and invested by the State Treasurer.

**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 to the quasi-endowment fund 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 capital facilities or 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](#).

### *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.

### **State Fiscal Effect:**

#### *Endowed University System of Maryland Scholarship Fund*

It is not known if the USM Board of Regents will transfer any funds for the purposes specified by the bill. The amount of annual private donations pledged for the scholarship also cannot be reliably estimated.

Under one scenario, as shown in **Exhibit 1**, assuming USM makes the one-time transfer in fiscal 2019, the USM fund balance decreases by an estimated \$50.0 million, with a commensurate increase in quasi-endowment funds to be invested. Under this assumption, as shown in Exhibit 1, fund revenues increase beginning in fiscal 2020. Exhibit 1 also reflects the following assumptions: a 1.37% projected rate of return for short-term investments held with the State Treasurer; a 7% average rate of return for the quasi-endowment fund; and 4.25% of the rolling three-year average value of the fund being available for scholarships with the remaining reinvested in the fund. Under this assumption, up to an estimated \$2.3 million is available for the scholarship established by the bill in fiscal 2020, increasing to an estimated \$6.9 million by 2030.

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**Exhibit 1**  
**Potential Scholarship Funds Available if USM Transfers \$50 Million**  
**And Other Specified Assumptions**  
**(\$ in Thousands)**

|                                | <u>FY 2019</u> | <u>FY 2020</u> | <u>FY 2021</u> | <u>FY 2022</u> | <u>FY 2023</u> |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| USM Transfer <sup>1</sup>      | \$50,000       | \$0            | \$0            | \$0            | \$0            |
| Donations <sup>2</sup>         | 5,000          | 5,000          | 5,000          | 5,000          | 5,000          |
| Scholarship Funds <sup>3</sup> | 0              | 2,338          | 2,526          | 2,722          | 3,125          |

USM: University System of Maryland

<sup>1</sup>Assuming maximum \$50.0 million one-time transfer from USM non-State-supported fund balance.

<sup>2</sup>Assuming \$5.0 million annual donations.

<sup>3</sup>Based on USM quasi-endowment policy, 4.25% of the rolling three-year average value of the fund is available for scholarships and the remaining interest is reinvested.

Note: Principal amount may be lost due to market risks.

Source: State Treasurer's Office; University System of Maryland; Department of Legislative Services

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An alternative scenario, as shown in **Exhibit 2**, assumes that USM does *not* make the fund balance transfer. Keeping the other assumptions constant, including the assumption of \$5.0 million in annual donations for the program, *up to* approximately \$213,000 is available for the scholarship in fiscal 2020, increasing to an estimated \$2.9 million by 2030.

Investment returns may be significantly lower or higher due to market risks, and the rate of return on Treasurer-held investments may vary. Any investment returns must be used for new or renewal scholarships or reinvested into the fund. Further, the principal may be lost due to market risks.

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**Exhibit 2**  
**Potential Scholarship Funds Available if No USM Transfer**  
**And Other Specified Assumptions**  
**(\$ in Thousands)**

|                                | <u>FY 2019</u> | <u>FY 2020</u> | <u>FY 2021</u> | <u>FY 2022</u> | <u>FY 2023</u> |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| USM Transfer <sup>1</sup>      | \$0            | \$0            | \$0            | \$0            | \$0            |
| Donations <sup>2</sup>         | 5,000          | 5,000          | 5,000          | 5,000          | 5,000          |
| Scholarship Funds <sup>3</sup> | 0              | 213            | 326            | 445            | 689            |

USM: University System of Maryland

<sup>1</sup>Assuming no funds transferred from the non-State-supported fund balance.

<sup>2</sup>Assuming \$5.0 million annual donations.

<sup>3</sup>Based on USM quasi-endowment policy, 4.25% of the rolling three-year average value of the fund is available for scholarships and the remaining interest is reinvested.

Note: Principal amount may be lost due to market risks.

Source: State Treasurer's Office; University System of Maryland; Department of Legislative Services

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The bill allows the principal to be used for renewal scholarships if the interest earnings are insufficient to provide renewal scholarships to participants. The bill also allows a constituent institution of USM to withdrawal specified amounts including principal from the fund. Any draw down of the principal amount will result in less money available for scholarships in future years.

*University System of Maryland Tuition Revenues and Expenditures*

There is no net impact on USM revenues and expenditures due to scholarships since USM institutions are not open enrollment institutions and can generally adjust their enrollment. Thus, the total number of students at any institution is not impacted. However, particular students may be able to attend an institution that they would not be otherwise able to attend.

*Student Loan Revenues*

Scholarship recipients who fail to fulfill the service obligation required by the bill have their scholarships converted to student loans, payable to the quasi-endowment fund. Thus, to the extent that recipients fail to fulfill these obligations, fund revenues increase further.

## *Maryland Higher Education Commission Expenditures*

General fund expenditures at MHEC increase when funding is available for scholarship awards. Assuming maximum funding available, MHEC could begin preparing in fiscal 2019 for making the awards the following year. For example, expenditures increase by \$60,000 for one-time programing costs to program the Maryland College Aid Processing System scholarship system for the new scholarship. In addition, a full-time administrative specialist is likely needed to oversee the program and process applications at an annual cost of approximately \$65,000.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** Although designated as a crossfile, HB 841 (Delegate Jones, *et al.* – Appropriations) is not identical.

**Information Source(s):** Maryland Higher Education Commission; University System of Maryland; Department of Budget and Management; Department of Legislative Services

**Fiscal Note History:** First Reader - March 5, 2018  
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