

SUBJECT: Establishing the Texas tomorrow fund II prepaid tuition program

COMMITTEE: Higher Education — committee substitute recommended

VOTE: 7 ayes — Morrison, F. Brown, Alonzo, Giddings, D. Howard, Patrick,
Rose

0 nays

2 absent — McCall, Aycock

WITNESSES: For — None

Against — None

On — Harrison Keller, Speaker Tom Craddick

BACKGROUND: The Higher Education Prepaid Tuition Program – originally called the Texas Tomorrow Fund – was established in 1995 and is administered by the Prepaid Higher Education Tuition Board in the Comptroller’s Office. The board helps Texans save for college through two programs, a prepaid plan that locks in future college tuition and fees at today's prices and a savings plan that allows individuals to invest money for college expenses. Four types of plans are available: a junior college plan, a senior college plan, a junior-senior college plan, and a private college plan. Purchasers buy credit hours in installments equal to one academic year and the state pays all tuition and fees for beneficiaries in accordance with the amount of purchased credit hours. The state constitutionally guarantees that contributions to the prepaid plan will cover the costs of attending college at some point in the future, so the state is obligated to pay the actual cost of tuition, whatever that might be.

Both plans are authorized under sec. 529 of the federal Internal Revenue Code, so investments grow tax-deferred, and distributions to pay for college are federally tax-free. The prepaid plan is similar to a defined benefits program like many traditional pension plans. A family contributes funds over time and receives a benefit, which is the purchase of so many hours of college credit. The savings plan is similar to a defined contribution plan, or a 401(k) retirement account. Periodic contributions

are invested by investment managers with the objective of increasing the value over time. Beneficiaries have only the funds they accumulate in their accounts to pay for tuition and fees, room and board and textbooks.

The board suspended enrollment in the prepaid plan in June 2003 because it could not accurately predict future college costs once the Legislature deregulated tuition. Because the prepaid plan is suspended, the savings plan is the only state-sponsored tool to help families save for college.

DIGEST:

CSHB 3900 would establish the Texas Tomorrow Fund II prepaid tuition unit undergraduate education program fund outside the state treasury, to be administered by the Prepaid Higher Education Tuition Board in the Comptroller's Office. The fund would receive deposits of money paid to purchase pre-paid tuition contracts and earnings from investments. The program would offer three pre-paid tuition units to Texas residents:

- Type I tuition unit: the cost of undergraduate resident tuition and fees charged by the general academic institution with the highest tuition and fee costs;
- Type II tuition unit: the weighted average undergraduate resident tuition and fees charged by general academic teaching institutions; and
- Type III tuition unit: the weighted average undergraduate resident tuition and fees of two-year institutions.

The purchaser could buy one type of unit or a combination of types. The purchase price each year would be based on the most recent year's tuition and fee charges at each type of institution. The purchaser could pre-pay the costs of all or a portion of the tuition and fees at general academic teaching institutions, two-year institutions, private or independent institutions, or accredited out-of-state institutions.

Each unit would be worth 1 percent of a year's tuition and fees at current prices. One hundred Type I units would be worth one year's tuition and fees at the highest-priced university, 100 Type II units would be worth one year's tuition and fees at a university at the weighted average, and 100 Type III units would be worth one year's tuition and fees at a community college at the weighted average. The cost of the units and returns on investment of the funds could be used as credit at state colleges and universities. Beneficiaries, or students, would have to enroll in the plan at least three years before they could use the funds and when the student

redeemed units, the universities would be required to honor the unit's value. When a student enrolled at a general academic or two-year institution, the state would pay the contract amount plus all interest earned on those amounts. Students who chose a private or out-of-state institution would get reduced benefits. The contracts would expire on the 10th anniversary of the high school graduation, excluding military service.

If the student redeemed fewer units than were necessary to pay their tuition and fees, the beneficiary would be responsible for paying the difference. If the student redeemed fewer tuition units than the student purchased, then the purchasers could redeem for cash the excess units for the purchase price of the units, plus an annual earned interest of 5 percent or less.

By January 1 of each year, the board would have to provide each purchaser an itemized statement of account that included detailed information on status of the account. By December 1 of each year, the board would have to submit to the governor, the lieutenant governor, the speaker of the house, the Legislative Budget Board, the Legislative Audit Committee, the state auditor, and the Texas Higher Education Coordinating Board (THECB) a report on the fiscal transactions, the market and book value of the fund, asset allocations, and other financial data, as well as report to the THECB complete contract sales information and projected enrollments of beneficiaries.

The bill would set forth provisions relating to the powers and duties of the board, the formulas for determining the annual pricing of the tuition units, contract specifications, payments options, and investment and use of fund assets. The board would be instructed to administer the fund in an actuarially sound manner and annually evaluate the soundness of the fund. It could temporarily suspend new enrollments in the program to ensure actuarial soundness. The bill would make other conforming requirements, including allowing the board to charge an administrative fee of up to \$25, allowing a change of beneficiary and deferred use of pre-paid credit hours, and other technical provisions.

The board could enter into contracts beginning September 1, 2008. The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2007.

**SUPPORTERS
SAY:**

CSHB 3900 would provide for a pre-paid tuition plan structured in a sound manner, which would help Texas families manage the costs of higher education and benefit the economy and society as a whole. The new Texas Tomorrow Fund II would help many families – particularly those in middle-income categories who did not qualify for financial assistance – to plan for their children’s college education by locking in tuition and fees at today’s rates.

Before the current prepaid tuition plan was suspended in 2003, families bought pre-paid contracts to pay for tuition and required fees at prices that were based on the actuarial projections of the future price of tuition and fees. The popularity of the pre-paid tuition plan clearly demonstrates that it fills a need for Texas families and students. However, the board decided to suspend any new enrollment because of the uncertain effect of tuition deregulation. The board could not accurately predict the future costs of tuition, and the state must pay all tuition and fees in accordance with the amount of purchased credit hours regardless of the actual cost of tuition and fees. The board could have jeopardized the plan’s assets by selling new tuition contracts at inadequate prices. Likewise, any university with tuition and fees above the weighted average tuition must waive the difference in cost between their tuition and the weighted average amount. According to the Sunset Advisory Commission, the six largest universities waived more than \$7 million in tuition for prepaid plan beneficiaries in 2005.

The Texas Tomorrow Fund II would be structured differently so that it would be a win-win situation for students, universities in some cases, and the state. The state would be obligated only to pay contract contributions and earned interest. Further, unit prices could change each year to accommodate changing tuition. Institutions would receive the unit price plus interest, so in years when interest exceeded the increase in the weighted average of tuition, schools would earn additional income. If universities raised tuition and fees at a slower rate, they actually could make money from the program. If they raised tuition and fees at a faster rate than the market returns, they would have to make up the difference between the value of the units and their tuition and fees. The bill would offer an incentive to universities to be judicious in raising tuition and required fees.

**OPPONENTS
SAY:**

No apparent opposition.

NOTES:

The companion bill, SB 1900 by Shapiro, has been referred to the Senate Education Subcommittee on Higher Education.

HB 2173 by B. Cook, the continuation of the Prepaid Higher Education Tuition Board under the Sunset process, is on the May 1 General State Calendar.