

TEXAS GUARANTEED TUITION PLAN



AN ISSUE BRIEF FROM LEGISLATIVE BUDGET BOARD STAFF

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OBJECTIVE

The Texas Guaranteed Tuition Plan is a prepaid tuition program projected to be insolvent by 2019.

KEY FACTS

- ◆ The Texas Guaranteed Tuition Plan opened for enrollment in January 1996 and was closed to enrollment in 2003, after tuition rates were deregulated.
- ◆ As of August 31, 2013, the plan's estimated unfunded liability is \$612.5 million.
- ◆ Plan assets are estimated to be exhausted in fiscal year 2019, requiring a legislative appropriation of approximately \$46.4 million in the 2018–19 biennium. This will grow to \$327.3 million in the 2020–21 biennium. Funding needs decline during each subsequent biennium. Obligations end in 2035.

BUDGETARY IMPACT

No budgetary impact is expected until fiscal year 2019.

STATUTORY REFERENCES

Texas Constitution, Article VII, Section 19, Texas Tomorrow Fund.

Texas Education Code, Chapter 54, Subchapter F, Texas Guaranteed Tuition Plan.

The Texas Guaranteed Tuition Plan (TGTP), one of the Texas Tomorrow Funds' prepaid tuition programs, is projected to become insolvent within the next five years. The August 2013 Actuary's Report indicated that the fund has a current funded ratio, or ratio of assets to liabilities, of 66.4 percent. The TGTP fund is diminishing and is closed to future entrants. The plan is backed by the full faith and credit of the state. This guarantee was voter approved by a constitutional amendment passed in November of 1997. Although no legislative appropriation is expected to be needed for the 2016–17 biennium, appropriations may be needed to fulfill the fund's contract obligations by fiscal year 2019.

OVERVIEW

TGTP allowed buyers to purchase prepaid tuition contracts that locked in future college tuition and fees at current rates. Contracts are purchased for use at senior colleges and universities, junior colleges, and private colleges and universities, pursuant to Texas Education Code, Chapter 54, Subchapter F. The fund opened for enrollment in January 1996. It was closed to further enrollment in 2003 following the deregulation of tuition rates, which allowed the boards of regents at universities to set their own tuition rates. The fund is operated by the Texas Prepaid Higher Education Tuition Board, which administers various college savings plans. State law requires annual consideration by the board of whether to re-open enrollment based on an evaluation of the actuarial condition of the plan. Enrollment has been suspended each year since 2003 through 2014. TGTP sold a total of 158,442 contracts, and there are 78,076 active contracts remaining as of August 2013.

FUND ASSETS AND LIABILITIES

Liabilities of TGTP include all future tuition and fee obligations for contracts purchased. Plan assets are comprised of all contributions and the returns generated from investment of the total fund. According to the August 31, 2013 Actuary's Report conducted by Sherman Actuarial Services, assets of TGTP total \$1,211.8 million compared to liabilities of \$1,824.3 million. The plan's unfunded liability is \$612.5 million, a decrease of \$31.2 million from the \$643.7 million unfunded liability as of August 31, 2012. The improved funding status is primarily due to tuition increases that rose at a rate less than expected and greater investment performance than assumed. Additional discussion about assumptions is found below.

FUND CONTRIBUTIONS AND DISTRIBUTIONS

Contributions received by the fund consist primarily of installment payments made on outstanding contracts. The actuary estimates contract payments will end in 2022. According to TGTP, the fund received approximately \$18.7 million in tuition contract payments and an estimated \$0.7 million in fees and other revenue in fiscal year 2013. Distributions to colleges and universities for tuition payments totaled \$150.1 million in fiscal year 2013. Additional distributions included \$1.4 million in administrative expense, \$2.1 million in investment expense, and \$36.2 million in refunds due to contract cancellations.

REFUNDING OF CONTRACTS

Refunds on the unused portion of a contract are available to contract purchasers who choose to cancel their contracts. Mature contracts are those whose beneficiaries are 18 years of age or older or who have completed high school. According to TGTP, refunds of mature contracts are based on the current hourly reimbursement rate for tuition and required fees paid by the plan for the contract type, minus administrative fees. Cancellations of non-mature contracts, those whose beneficiaries have not graduated from high school, return total contributions less any administrative fees. A total of \$36.2 million was distributed in fiscal year 2013 to contract purchasers for refunds due to cancellations. Of this amount, \$18.6 million reflects actual contribution payments, and \$17.6 million represents the difference in contract payments received and the amount of actual tuition and fees.

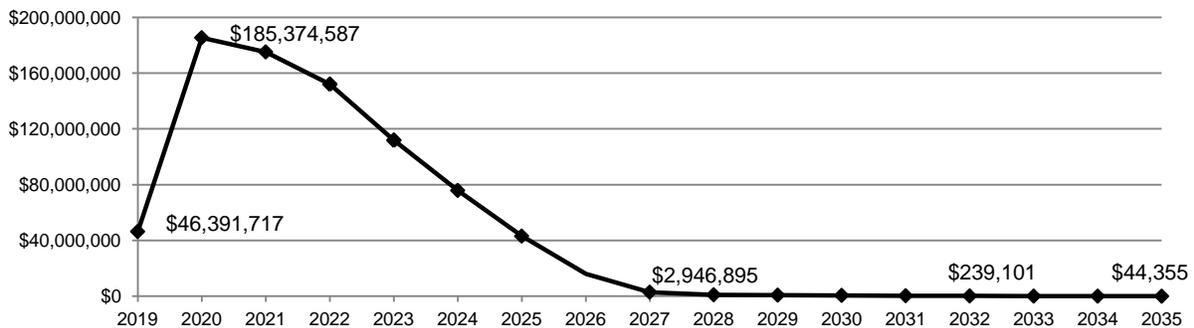
ASSUMPTIONS

Several actuarial assumptions can impact the unfunded liability of the TGTP fund including investment yield, rate of tuition increases, contract withdrawal rates, and fund expenses. The actual investment return in fiscal year 2013 was 5.29 percent, compared to 5.0 percent assumed in the 2012 valuation. The result was an asset gain of \$3.4 million. Likewise, actual tuition increases were more favorable to the fund as compared to actuarial assumptions. Senior college tuition increased 2.7 percent, compared to an assumption of 6.3 percent. Junior college tuition increased 2.25 percent, compared to an assumed 5.2 percent. Private college tuition increased 6.67 percent, compared to an assumed 7.3 percent. The actual tuition experience resulted in an actuarial gain of approximately \$57.6 million in fiscal year 2013.

FUND OUTLOOK

The Texas Guaranteed Tuition Plan is projected to exhaust all assets during fiscal year 2019, which would require legislative appropriations in the 2018–19 biennium to meet the state’s full faith and credit clause backing the fund. According to Sherman Actuarial Services, \$154.2 million is the estimated remaining fund balance at the end of fiscal year 2018. This fund balance at the beginning of fiscal year 2019 coupled with contract collections will somewhat offset the expected cash expense of \$205.4 million in fiscal year 2019. However, a shortfall of approximately \$46.4 million would remain. Once the fund is depleted, it would become a pay-as-you-go program and would require a legislative appropriation for the full expected benefit payments, less estimated contract payment receipts each biennium. The actuary estimates \$327.3 million in appropriations would be needed in the 2020–21 biennium, declining to \$264.0 million in the 2022-23 biennium, and \$119.0 million in the 2024-25 biennium. As of August 31, 2013, a total of \$812.4 million is the estimated funding need to support future benefit payments and expenses beginning in fiscal year 2019 through fiscal year 2035, when obligations are scheduled to end. Fig. 1 shows annual funding needs estimated by the TGTP actuary from fiscal year 2019 through fiscal year 2035.

FIG. 1
TEXAS GUARANTEED TUITION PLAN – ACTUARY’S ESTIMATE OF PAY-AS-YOU-GO FUNDING NEEDS, 2019–2035



SOURCE: TGTP Actuary’s report on Program Soundness, August 31, 2013

VARIANCE

The Actuary’s Report includes valuations for alternative scenarios to show how actual experience compared to actuarial assumptions would affect the estimated fund deficit. For example, the unfunded liability would increase from \$612.5 million to approximately \$680 million if either the investment return is 1.0 percent lower than assumed or if tuition increases are 1.0 percent higher in each future year than assumed.

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