



Planning for Tomorrow: The Texas Guaranteed Tuition Plan

by James Quintero
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KEY POINTS

- Without aggressive action, the Texas Guaranteed Tuition Plan is likely to become insolvent between 2015 and 2017.
- The board's decision to change the program's refund policy will help reduce costs by more than \$60 million.

In December 2009, the state's prepaid tuition program, the Texas Guaranteed Tuition Plan (TGTP), will change the way it allows enrollees to collect refunds on canceled contracts.

Under the new system, contract holders who pre-pay for their children's tuition and fees will only be eligible for a refund of their principal investment, minus administrative fees.* Currently, policyholders are able to collect their original investment plus earnings based on the rate of tuition inflation over the life of the contract, minus administrative fees.

The Texas Prepaid Higher Education Tuition Board's decision to change the refund policy—which is explicitly allowed in the contracts that every parent signed upon joining the program[†]—came about, in part, as a result of the program's pending insolvency.

As early as 2015, the program could run out of money to pay contract benefits, according to the Texas Comptroller. Were this to happen, the Legislature would have to directly fund the program to the tune of \$65 million in 2015 and \$434 million in the 2016-17 biennium. By 2030, the TGTP would likely face a budget shortfall of up to \$2.1 billion.¹

The program's financial woes have worsened due to a sagging economy, higher-than-expected tuition inflation, and a depreciation of assets.

However, board members have been quick to recognize the magnitude of the TGTP's financial difficulties and have taken prompt action to begin to stabilize the fund while continuing to meet its program obligations.

A Guaranteed Rate of Return

Parents with the wherewithal to buy into the program saw tremendous risk-free growth in their investments, particularly as the cost of tuition at public universities has surged in recent years.

It is hard to believe that the Legislature intended the TGTP to be an all-purpose, taxpayer-guaranteed savings plan and that voters approved it for that purpose. Yet that is exactly what it has turned out to be.

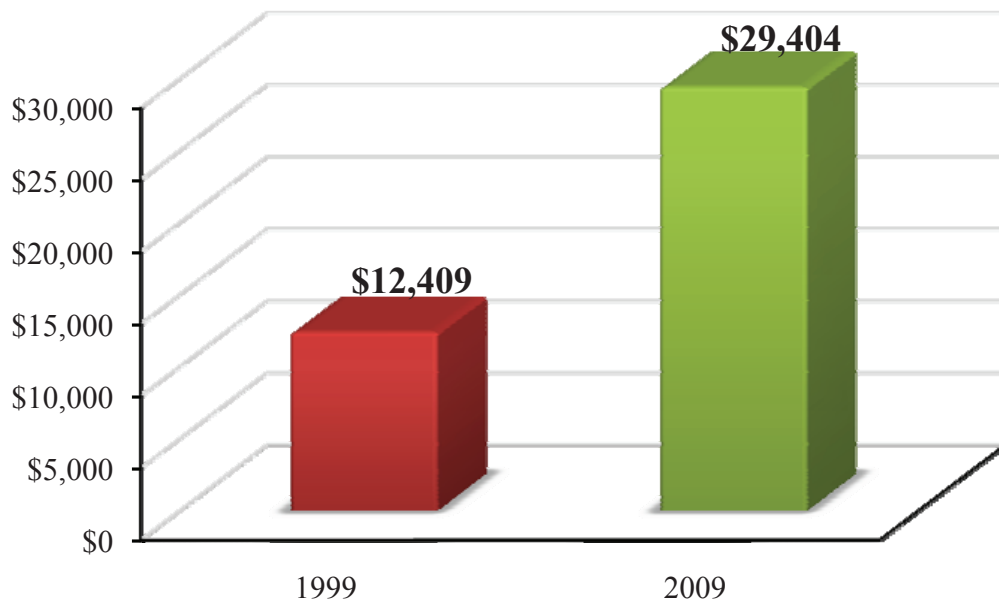
The constitutional amendment adding the program to the state's Constitution is quite clear; the goal is "to encourage persons to plan and save for young Texans' college education, to extend the full faith and credit of the state to support the Texas Tomorrow Fund of the prepaid higher education tuition program, and to create the Texas Tomorrow Fund as a constitutional trust fund."²

However, the system's current rules encourage people to use it as a constitutionally guaranteed investment vehicle.

* Cost of administrative fees vary according to payment method. For contracts purchased in a lump-sum agreement, purchasers are required to pay a \$25 cancellation charge plus a \$20 fee. For contracts purchased in monthly installments, purchasers are required to pay a \$25 cancellation charge plus a \$36 fee.

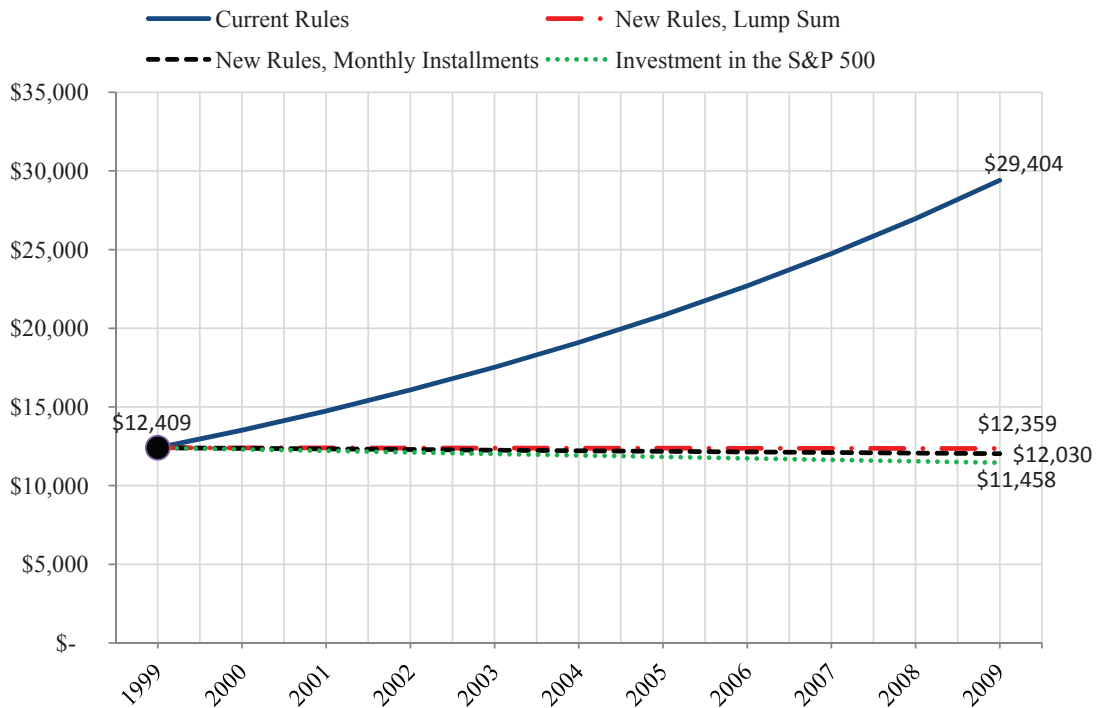
[†] The program's Master Agreement states that "program provisions may be amended by the Board from time to time if the Board determines it is in the Program's best interests."

10-Year Investment Under Current Refund Policy



Source: Texas Comptroller of Public Accounts

Investment Comparison Between Current Rules, New Rules, and the S&P 500 September 1999 through September 2009



Source: Texas Comptroller of Public Accounts

When one compares the 10-year growth from the state's pre-paid tuition program versus that of an investment in the S&P 500, the egregiousness of the program's current refund policy becomes even more obvious.

A person who purchased a contract in September 1999 at a cost of \$12,409 could cancel their contract today under the current refund policy and collect \$29,404—a return on investment of 9.01 percent per year compounded, with a gain of 137 percent over 10 years.³ By contrast, investors who put the same amount of money—\$12,409—into an S&P 500 index fund 10 years ago have seen a negative rate of return, with their investment worth only \$11,458 today.⁴

The New Refund Policy

The board's decision to change the TGTP's refund policy will not only help reduce costs by over \$60 million,⁵ but it will also address the use of the prepaid tuition program as

a government-operated investment vehicle with a taxpayer-guaranteed rate of return.

Though the plan will no longer provide windfall investment returns, plans under the new rules would still outperform an investment in the S&P 500. A \$12,409 lump sum contract purchased 10 years ago under the new refund policy would be worth \$12,359 today, while a contract purchased under the program's monthly installment plan would be worth \$12,030. To be fair, it is plausible to select past data points where the S&P 500 outperforms the returns of either plan under the new rules; but as it stands today, the data indicates otherwise.

Ultimately, the board has a responsibility—both to the beneficiaries and to the taxpayers—to keep the program financially sound. Doing otherwise threatens the program's long-term viability and the taxpayers who support it. ★

Endnotes

¹ Letter from Texas Comptroller of Public Accounts Susan Combs to State's Leadership, June 10, 2009.

² Texas Legislature Online, House Joint Resolution 8 (17 Feb. 1997) <http://www.legis.state.tx.us/tlodocs/75R/billtext/html/HJ00008F.htm>.

³ Letter from Texas Comptroller of Public Accounts Susan Combs to State's Leadership, June 10, 2009.

⁴ *Standard & Poor's Reports August 2009 Index Returns* (1 Sept. 2009) <http://www2.standardandpoors.com/spf/pdf/index/tr.pdf>.

⁵ Letter from Texas Comptroller of Public Accounts Susan Combs to State's Leadership, June 10, 2009.

About the Author

James Quintero is a fiscal policy analyst at the Texas Public Policy Foundation. He joined the Foundation's Center for Fiscal Policy in March 2008 and contributes to the following issues: restricting the growth of taxation; appropriations reform; increasing governmental transparency at both the state and local level; and instituting expenditure limits.

Prior to joining the Foundation, James completed his Master's of Public Administration degree with an emphasis in Public Finance at Texas State University–San Marcos. His Applied Research Project, "Regional Economic Development: An Economic Base Study and Shift-Share Analysis of Hays County, Texas" is currently featured on the TSU website. During the course of his graduate studies, he also worked as a Graduate Research Assistant for the university's Scholarships and Financial Aid Administration Department.

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