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## **Alabama's Prepaid Affordable College Tuition (PACT) Program Executive Summary**

### **The Problem**

Alabama's PACT program was started in 1990 as a savings plan to help parents or guardians of children in Alabama pay for their in-state college tuition and fees. The program is managed through the Alabama State Treasury by a 10-member board of directors, which includes the State Treasurer and the Lieutenant Governor. As of September 2009, there were 45,542 active PACT contracts. New enrollment in the PACT program has been suspended since January 2009 because of the program's financial problems.

Since 2007, Alabama's Prepaid Affordable College Tuition (PACT) program has lost almost a quarter of a billion dollars of its value, more than any other state with a similar program. Not only has this 30 percent loss compromised the program's ability to pay college tuition and fees for investors; it raises serious questions regarding the investment strategies of the PACT Board.

Every pre-paid college tuition program in the nation operates under an investment policy which dictates the amount of money that can be invested in equities (e.g., stocks and mutual funds), fixed income funds (e.g., bonds), and other investments (e.g., real estate, cash, or cash equivalents such as money market accounts).

Even prior to the current recession, Alabama's high ratio of equities to fixed income funds set it apart from similar programs across the nation. While the national average for tuition programs in 2007 was 59.3 percent equities, Alabama's PACT program was 72 percent, the second highest in the nation.

Historically, equity investments provide higher returns, but also come with higher risk. Because Alabama's PACT program was extremely dependent upon the equities for its funding, it suffered considerably more during the market collapse of 2008 than other programs that had better ratios of other investments. According to an independent auditor's report on PACT for fiscal year 2009, its assets fell from \$817.2 million in 2007 to \$571.1 million in

2009, a 30 percent loss. In fact, of the 13 state prepaid affordable college tuition programs examined in a 2010 research paper by the Alabama Policy Institute, Alabama's \$246 million loss from 2007 to 2009 was the largest dollar loss in assets of any program in the nation.

On April 22, 2010 the State Legislature approved an amended bill to pay \$547.6 million over 13 years to subsidize the PACT program. The bill allows the PACT program to begin drawing funds from the state's Education Trust Fund in 2015 to cover the anticipated shortfall for the 44,000 children in existing contracts.

Unfortunately, PACT analysts predict the program will still dry up in 2016 because the new legislation did not put tuition and fee increase limits on Auburn University and the University of Alabama, where 55 percent of all PACT students attend. Because these limits were not applied across the board, another \$269 million may be needed to keep the program solvent.

### **Our Solution**

If Alabama's PACT program is to meet or satisfy its obligations to its participants, it must make changes to ensure its solvency, particularly if it is to ever re-open to new enrollees.

- It must lower its ratio of equities to fixed income investments to a balance that is more in line with the national average of about 60 percent equities and 40 percent fixed income. At the same time, this ratio must not become too dependent upon lower-performing fixed income investments, as it could raise the price of tuition units, making the program less cost-effective for all participants still paying into it.
- If the PACT remains closed to new enrollees, it must continue to bring in revenues to offset future gains in tuition, as well as to erase its current losses. To reduce the likelihood of future losses, the program's assumption of the state's tuition growth rate could be increased, which would translate into requiring larger deposits from its participants.
- Making up the large losses already sustained by the PACT program is considerably more difficult. At present, every solution requires either a direct contribution by the state, a loan by the state or one of its agencies (which might not be repaid in full), or it passes the risk to another body that could suffer the same fate as the PACT program has since 2007.
- To keep PACT solvent, limits on tuition and fees increases must be put in place for all schools participating in it.
- Finally, if the decision is made to re-open the PACT program to new enrollees, an adjustable stabilization reserve should be created to help the program adapt to short-term changes in tuition costs, investment

returns, and purchaser behavior. The risk of insolvency could be further reduced by increasing the projection of the state's average annual tuition growth rate and/or lowering the value of payouts to new participants. Either of these choices, though, runs the risk of making the program unattractive to some would-be enrollees.

The State of Alabama has made a legal agreement with the families of those enrolled in PACT to pay for their tuition. While these changes are potentially painful to taxpayers, PACT enrollees, and the schools they attend, the state must honor its contracts while keeping its external costs as low as possible.