



Annual Financial Report

June 30, 2017 and 2016

PHEAA conducts its student loan servicing operations commercially as American Education Services and for federally-owned loans as FedLoan Servicing.





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Ernst & Young LLP
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Management and the Board of Directors
Pennsylvania Higher Education Assistance Agency

Report on the Financial Statements

We have audited the accompanying financial statements of the Pennsylvania Higher Education Assistance Agency (PHEAA), a component unit of the Commonwealth of Pennsylvania, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise PHEAA's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of PHEAA at June 30, 2017 and 2016, and the results of changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.



Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, the required schedules of PHEAA's proportionate share of the net pension liability and PHEAA's contributions on pages 4 - 36 and 77 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Ernst & Young LLP

Baltimore, Maryland
September 21, 2017



The Pennsylvania Higher Education Assistance Agency's ("PHEAA" or "Agency") Management's Discussion and Analysis ("MD&A") is required supplementary information. The MD&A introduces the basic financial statements and provides an analytical overview of our financial activities. Please read it in conjunction with the Basic Financial Statements that follow this discussion.

About PHEAA

Our mission is to improve higher education opportunities for Pennsylvanians. We are a public corporation and government instrumentality created by the Pennsylvania General Assembly. We serve students and schools nationally through our state grant, guaranty, servicing, and financial aid processing systems.

We administer the Pennsylvania State Grant program, as well as other grant programs, on behalf of the Commonwealth of Pennsylvania ("Commonwealth") each year without taxpayer support. We use our business earnings to fund the administration of these programs ensuring that every appropriated dollar goes directly to students.

We are governed by a Board of Directors and administered by a President/Chief Executive Officer and staff. We have approximately 3,600 employees and contractors and our principal offices are located in Harrisburg, Pennsylvania, with four regional offices located throughout Pennsylvania.

Our business activities are subject to audit by the Pennsylvania Department of Auditor General and we are required to make an annual report to the Governor of Pennsylvania ("Governor") and the legislature showing our financial condition at the end of the Commonwealth's fiscal year.

Public Service Benefits and Grant Programs

On June 16, 2016, the Board of Directors approved that the President/Chief Executive Officer be given the authority to allocate funds to the following grant programs for fiscal year 2016-17:

- Pennsylvania State Grant Program - Up to \$125.0 million;
- Pennsylvania Distance Education Program - \$10.0 million; and
- Pennsylvania Targeted Industry Cluster Certificate Scholarship Program - \$6.0 million.

On July 12, 2016, the Commonwealth's Enacted Budget for fiscal year 2016-17 (Senate Bill No. 1073, printer's number 2009) ("Enacted Budget") became law (Act 16A). The Enacted Budget allocates funding levels to the following programs for fiscal year 2016-17:

- Pennsylvania State Grant Program - \$272.9 million;
- Institutional Assistance Grant Program - \$25.7 million;
- Matching Funds Grant Program - \$12.5 million;
- Pennsylvania Ready to Succeed Scholarship Program - \$5.0 million;
- Higher Education for the Disadvantaged Program - \$2.2 million;
- Cheyney University Keystone Academy Program - \$1.8 million;
- Horace Mann Bond-Leslie Pickney Hill Scholarship for outreach and recruitment activities at Lincoln and Cheyney Universities Program - \$697 thousand;
- Pennsylvania Internships Program Grants - \$350 thousand; and
- Higher Education of Blind or Deaf Program - \$47 thousand.

PHEAA provided an \$87.0 million supplement to the \$272.9 million allocation by Act 16A to the Pennsylvania State Grant Program. The combination of the Commonwealth's allocation and PHEAA's supplement resulted in total funding of \$359.9 million to the Pennsylvania State Grant Program, which allowed for the funding of approximately 143 thousand awards with a maximum award of \$4,378 for the 2016-17 award year.



The following table highlights the public service benefits and the operating expenses incurred by us in operating state and federal programs as well as public service activities.

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
<u>Self-funded</u>			
Pennsylvania State Grant Program Supplement	\$ 87,000	125,000	75,000
Costs of operating state and federal governmental programs	16,552	15,313	15,399
Pennsylvania Distance Education Program Supplement, net of refunds	12,974	10,323	7,313
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds	6,990	4,886	4,373
Other public service activities and outreach	3,089	2,910	2,684
Total self-funded activities	\$ 126,605	158,432	104,769

As of June 30, 2017, the Pennsylvania State Grant Program Supplement was \$87.0 million, a 30.4% decrease from \$125.0 million in 2016. As of June 30, 2016, the Pennsylvania State Grant Program Supplement was \$125.0 million, a 66.7% increase from \$75.0 million in 2015. The decrease and increase in the Pennsylvania State Grant Program Supplement were due to the changing needs of the Pennsylvania State Grant Program.

As of June 30, 2017, the Pennsylvania Distance Education Program Supplement, net of refunds, was \$13.0 million, a 26.2% increase from \$10.3 million in 2016. The increase was due to the disbursement of prior period carryover amounts during the current period. As of June 30, 2016, the Pennsylvania Distance Education Program Supplement, net of refunds, was \$10.3 million, a 41.1% increase from \$7.3 million in 2015. The increase was due to an increase in students enrolled in on-line studies at participating schools.

As of June 30, 2017, the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds, was \$7.0 million, a 42.9% increase from \$4.9 million in 2016. As of June 30, 2016, the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds, was \$4.9 million, an 11.4% increase from \$4.4 million in 2015. The increases were due to an increase in recipients receiving awards.

We administer various programs to help students pursue higher education with the most significant Commonwealth programs as follows:

- PHEAA administers the Pennsylvania State Grant Program, which is the largest of the Commonwealth supported student aid programs. Every dollar allocated for the Pennsylvania State Grant Program from the Commonwealth goes directly to students. In the table that follows, we present the maximum grant award and the approximate number of grant recipients for the Pennsylvania State Grant Program.

(Dollars and numbers in actual amounts)

For the years ended June 30,	2017	2016	2015
Maximum grant award	\$ 4,378	4,340	4,011
Grant recipients (approximately)	# 143,000	154,000	174,000

- The Institutional Assistance Grants ("IAG") Program serves as an integral part of the Commonwealth's commitment to the development and preservation of a planned system of postsecondary education. The IAG program goals are fulfilled through formula grants, which help non-profit independent, postsecondary institutions to maintain enrollment levels and stabilize costs.



- The Matching Funds Program provides financial assistance to higher education institutions to assist them in capturing federal funds that require a state or local match as part of the federal grant award. It also provides matching grants to scholarship awards made by selected non-profit foundations.
- The Pennsylvania National Guard Education Assistance Program (“EAP”) is for members of the Pennsylvania National Guard. This program provides tuition assistance for students who enter into a service commitment with the Pennsylvania National Guard, typically for a period of six years. The maximum EAP award for full-time students (undergraduates) is the lesser of the actual tuition charged for the full-time course of study, or 100% of the tuition charged to a Pennsylvania resident at a state-owned university.
- The Postsecondary Educational Gratuities Program (“PEGP”) assists birth or adoptive children of Pennsylvania police officers, firefighters, rescue and ambulance squad members, corrections employees and National Guard members who died in the line of duty since January 1, 1976. The program also includes the birth and adoptive children of Pennsylvania sheriffs, deputy sheriffs and certain other individuals who were on federal or state active military duty who died in the line of duty since September 11, 2001. The PEGP covers all institutional charges for tuition, fees, room and board not covered by other grants and scholarships for students attending public colleges and universities in Pennsylvania.
- The Ready To Succeed Scholarship Program (“RTSS”) provides awards to high achieving students whose annual family income does not exceed \$110,000. Students must be nominated by their post-secondary institution for participation in the program and the awards from the RTSS can be used to cover tuition, books, fees, supplies, and living expenses.

Finally, we fund other public service and outreach initiatives to ensure students are aware of the financial aid opportunities available to them and to avert student loan defaults.

Operations

To serve Pennsylvanians effectively, we operate both inside and outside Pennsylvania and our primary operations involve servicing activities, student loan holdings and guaranty activities. In the table that follows, we present our total assets managed.



(Dollars in thousands)

As of June 30,	2017	2016	2015
Commercial Servicing:			
Client-owned student loans	\$ 35,955,741	40,378,802	45,013,515
PHEAA and PHEAA Student Loan Trust owned student loans	5,030,940	5,947,255	6,944,630
Total commercial servicing	40,986,681	46,326,057	51,958,145
Federal Servicing	295,842,021	264,640,157	226,418,604
Remote Servicing:			
Federal servicing	38,851,713	34,189,955	34,117,746
Commercial servicing	17,079,248	13,291,354	10,893,034
Total remote servicing	55,930,961	47,481,309	45,010,780
Total servicing	392,759,663	358,447,523	323,387,529
Guaranty:			
Original principal outstanding	26,125,091	29,013,133	31,898,600
Inventory of defaulted loans	4,103,245	4,741,697	5,023,164
Total guaranty	30,228,336	33,754,830	36,921,764
Total assets managed	\$ 422,987,999	392,202,353	360,309,293

Servicing Activities

We use our proprietary COMPASS system for servicing student loans that we own and loans owned by third parties through our Commercial Servicing, FedLoan Servicing (“FLS”), and Remote Servicing lines of business. COMPASS is a mainframe-based decision support tool that is utilized by our personnel, as well as multiple clients that include lending institutions, academic institutions and other higher education servicing agencies. Each client’s data is logically tagged, secured, and monitored with strict access controls.

Commercial Servicing

Our Commercial Servicing line of business services student loans owned by us and loans owned by third parties, which were originated under the Federal Family Education Loan (“FFEL”) program, prior to July 1, 2010, and various alternative loan programs.

FLS Servicing

Our FLS line of business services FFEL and William D. Ford (“Direct Loan”) program loans, which are owned by the United States Department of Education (“ED”). We are one of four Title IV Additional Servicers (“TIVAS”) that service student loans owned by ED and our contract expires on June 16, 2019. New loan volume is allocated based on the performance criteria established by ED in accordance with congressional legislation.

Servicing Solution

In April of 2016, ED announced a solicitation to move to a single student loan servicing system and servicer, with the potential for additional servicers to be added at a later time. PHEAA responded to this solicitation and was selected as one of three finalists in July of 2016. PHEAA responded to the second phase of the solicitation in January of 2017 and a revision to the second phase in July of 2017.

On August 1, 2017, ED released a notice cancelling the servicing solution solicitation in its entirety. ED plans a financial services/student loan industry-wide collaborative information gathering effort and plans to engage various



stakeholders and industry technology leaders as it determines how to approach servicers after the current contract expires on June 16, 2019.

Remote Servicing

Our Remote Servicing line of business provides our system to guarantors, other servicers, and NFP servicers to use in their internal servicing operations.

Student Loan Holdings

Our ability to originate student loans under the FFEL program was terminated on June 30, 2010. Currently, all new Stafford, Parent Loan for Undergraduate Students ("PLUS") and Consolidation student loans are originated under the Direct Loan program. We are authorized to purchase FFEL program and alternative student loans that we service for third parties and from banks and other lenders. We also are able to purchase, hold and finance loans that are rehabilitated by our guarantee agency. In June 2017, PHEAA's Board of Directors passed a resolution to authorize a trial program where the Agency can purchase and finance alternative loan portfolios that come up for sale, provided we are the current servicers.

We earn interest on student loans as well as subsidies and special allowance payments on certain FFEL program student loans within our student loan portfolio. ED makes interest subsidy payments to holders of qualifying FFEL program loans under the Higher Education Act of 1965, as amended, on subsidized Stafford loans and qualifying Consolidation loans, while the student is a qualified student, during a qualifying grace period and during periods of deferment. ED pays the interest subsidy payments based on the amount of interest accruing on the unpaid balance, prior to the commencement of repayment or during the deferment period. We record the interest subsidy payments as "Student Loan Interest Revenue, net".

ED makes special allowance payments to holders of qualifying insured loans and guaranteed loans, subject to certain requirements under the Higher Education Act of 1965, as amended. ED makes the payments during any quarter in which the special allowance calculation is a positive number. For loans first disbursed between April 1, 2006 and June 30, 2010, ED will collect excess interest for quarters in which the interest rate on the loan exceeds the special allowance support level, commonly referred to as negative special allowance. We record the special allowance payments as "Student Loan Interest Revenue, net".

Special allowance rates vary according to the type of loan, the date of the loan disbursement, the loan period and the loan status. ED calculates the special allowance rates using the following factors:

- The average of the bond equivalent rates on the quotes of the 3-month financial commercial paper rates in effect for each of the days in such quarter as reported by the Federal Reserve in Publication H-15 (or its successor) for such 3-month period;
- The average of the bond equivalent rates of the quotes of the 1-month London Inter-Bank Offered Rate ("LIBOR") in effect for each of the days in such quarter as compiled and released by the British Bankers Association;
- The average bond equivalent rate of the 91-day Treasury bills as published by the Department of Treasury; and
- A factor prescribed by law for each category of loans. This factor is added to or subtracted from the applicable 3-month financial commercial paper rate, 1-month LIBOR or 91-day Treasury bill rate.

In addition, we are required to pay ED a monthly Consolidation Loan Rebate Fee as a holder of Federal Consolidation loans. The Consolidation Loan Rebate Fee is equal to 0.0875% of the unpaid principal balance and the accrued interest on all Federal Consolidation Loans disbursed after October 1, 1993, and held by the lender on the last day of the month. This is equal to an annualized rate of 1.05%. Except for loans based on applications received during the period from October 1, 1998 and January 31, 1999, for which the rebate is equal to 0.05167% on a monthly basis or 0.62% on an annual basis.



Guaranty Activities

Our guarantee line of business facilitates the guarantee of at least 97% of the principal and accrued interest on Stafford, PLUS, Supplemental Loans for Students (“SLS”) and Consolidation loans made by a lender prior to July 1, 2010, in which the lender is party to a guarantee agreement with us.. We also manage the Federal Student Loan Reserve Fund (“Federal Fund”) for ED. We

We have a federal reinsurance agreement and a supplemental guarantee agreement with ED in which ED will reimburse the Federal Fund for at least 75%, and as much as 100%, of amounts expended resulting from defaulted loans, depending on the default rates of our portfolio of guaranteed loans for that fiscal year and the disbursement date of the loan. In addition, we have agreements with ED in which ED will reimburse us for 100% of the amounts expended by us resulting from the bankruptcy, death or disability of the borrower. Prior to December 1, 2015, the reinsurance rates, based on loan disbursement dates, were as follows:

▪ Before October 1, 1993	80% - 100%
▪ Between October 1, 1993 and September 30, 1998	78% - 98%
▪ Between October 1, 1998 and June 30, 2010	75% - 95%

On December 18, 2015, the Consolidated Appropriations Act, 2016, was signed into law and amended the maximum reinsurance rate within Section 428(c)(1) of the Higher Education Act by striking 95% and inserting 100%. This change was effective for all claims paid by the guarantor on or after December 1, 2015.

We have established a loan rehabilitation program for all borrowers with an enforceable promissory note. However, the following circumstances will exclude a borrower from the loan rehabilitation program:

- For any student loan that was rehabilitated on or after August 14, 2008, the borrower cannot rehabilitate the student loan again if the student loan returns to default status following the rehabilitation;
- A judgment has been obtained on the loan;
- Default claims were filed on the loan under the Code of Federal Regulations, Title 34, Chapter VI, Sec. 682.412 (Consequences of the failure of a borrower or a student to establish eligibility); and
- The borrower has been convicted of, or has pled nolo contendere or guilty to, a crime involving fraud in obtaining Title IV, Higher Education Act program assistance.

A borrower must meet the following requirements for us to consider the loan rehabilitated:

- The borrower has made nine of the ten payments required under a monthly repayment agreement;
- Nine payments have been received by us within a ten month period; and
- The loan is sold to an eligible lender.

Once the borrower meets the above program requirements, the borrower regains all benefits of the loan program, including any remaining deferment eligibility. In order to facilitate the sale of the rehabilitated student loans to eligible lenders, we purchase and sell rehabilitated student loans to eligible lenders.

For the year ended June 30, 2017, the average original principal balance outstanding of student loans we guaranteed was \$27.6 billion compared to \$30.5 billion in 2016 and \$33.6 billion in 2015. For more information on the Federal Fund, see the section titled “**Federal Student Loan Reserve Fund (Federal Fund)**” within the MD&A.

Cohort Default Rate

The cohort default rate is defined as the percentage of those borrowers who enter repayment on certain FFEL program loans during a particular fiscal year and default within the same fiscal year or within the next two fiscal years. The phrase “three-year cohort default period” refers to the three-year period that begins on October 1 of the fiscal year when the borrower enters repayment and ends on September 30 of the second fiscal year following the fiscal year in which the borrower entered repayment. On October 28, 2009, ED published in the Federal Register the regulations that govern the calculation of the 3-year cohort default rates beginning with the fiscal year 2009 cohort year. Our 3-year cohort default rate for fiscal year 2013, the most recent year available, was 8.9%, which was better than the national industry average of 11.3%. Our 3-year cohort default rates for fiscal years 2012 and 2011 were 8.8% and 9.3%, respectively, which were better than the national industry averages of 11.8% and 13.7%, respectively.



Description of the Basic Financial Statements

We follow the accounting and financial reporting guidance issued by the Governmental Accounting Standards Board ("GASB"). The Statements of Revenues, Expenses and Changes in Net Position and Statements of Net Position are prepared using the economic resources measurement focus and accrual basis of accounting.

The Statements of Revenues, Expenses and Changes in Net Position report our revenues and expenses. These statements measure the results of our operations over a period of time.

The Statements of Net Position include recorded assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position. Assets are resources with present service capacity that we presently control. Deferred outflows of resources are the consumption of net position that is applicable to a future reporting period. Liabilities are present obligations to sacrifice resources that we have little or no discretion to avoid. Deferred inflows of resources are the acquisition of net position that is applicable to a future reporting period. Net position remains after assets plus deferred outflows of resources, less liabilities and deferred inflows of resources. These statements report our assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position at a point in time.

The Statements of Cash Flows supplement these statements by providing relevant information about cash receipts and payments over a period of time.

The notes to the financial statements are an integral part of the financial statements and contain important information necessary to get a complete view of our finances.



Condensed Financial Information

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
Student loan interest revenue, net	\$ 143,789	147,512	154,985
Investment interest revenue	15,961	6,615	5,679
Interest expense on student loan financings, net	(37,781)	(37,324)	(42,058)
Interest expense on other financings, net	(425)	(502)	(580)
Net interest revenue	121,544	116,301	118,026
Provision for loan losses	(3,895)	(6,741)	(7,152)
Net interest revenue after provision for loan losses	117,649	109,560	110,874
Total noninterest revenue	518,953	515,981	458,337
Operating revenues	636,602	625,541	569,211
Total operating expenses	(570,923)	(528,615)	(458,286)
Operating income	65,679	96,926	110,925
Non-operating gains (losses)	78	(114)	(232)
Income before grants and financial aid	65,757	96,812	110,693
Total grants and financial aid, net of refunds	(130,436)	(149,121)	(65,345)
Change in net position	(64,679)	(52,309)	45,348
Net position, beginning of period	751,711	804,020	758,672
Net position, end of period	\$ 687,032	751,711	804,020

Student loan interest revenue is net of consolidation loan rebate fees, government interest income, negative special allowance, amortization of student loan purchase premiums and discounts, income based repayment income and recoveries/write-offs.

Interest expense on student loan financings is net of the amortization of deferred gains (losses) on bond refundings and the amortization of the discounts on student loan floating rate notes.

Interest expense on other financings is net of the amortization of premium on capital acquisition refunding bonds.



Statements of Net Position

(Dollars in thousands)

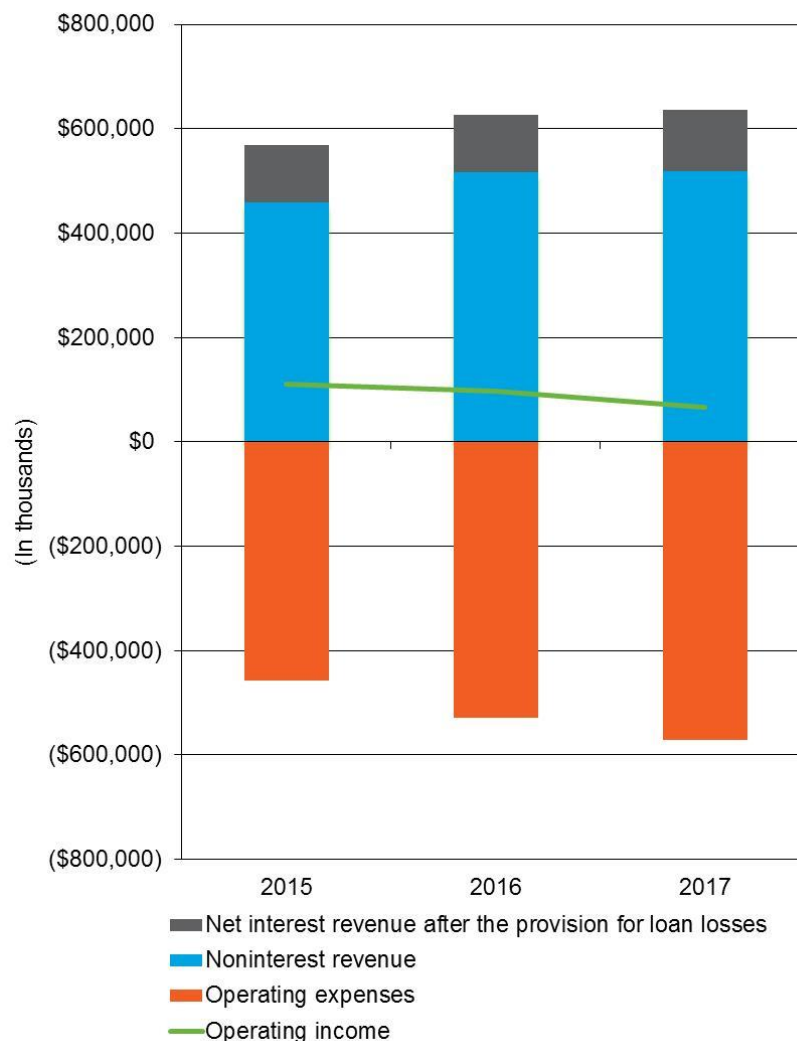
As of June 30,	2017	2016	2015
Current assets:			
Cash, cash equivalents, and investments (restricted and unrestricted)	\$ 1,097,158	950,524	1,014,822
Student loans receivable	788,882	962,917	1,095,033
Other assets	193,122	237,157	280,832
Total current assets	2,079,162	2,150,598	2,390,687
Long-term assets:			
Student loans receivable, net	4,224,277	4,955,122	5,819,102
Other assets	88,238	79,087	75,959
Total long-term assets	4,312,515	5,034,209	5,895,061
Total assets	6,391,677	7,184,807	8,285,748
Total deferred outflow of resources	134,810	128,125	41,961
Current liabilities:			
Student loan financings	200,000	938,213	903,779
Other liabilities	257,980	242,884	217,216
Total current liabilities	457,980	1,181,097	1,120,995
Long-term liabilities:			
Student loan financings, net	4,762,797	4,751,841	5,852,233
Net pension liability	474,743	440,673	323,866
Other liabilities	49,829	52,316	56,297
Total long-term liabilities	5,287,369	5,244,830	6,232,396
Total liabilities	5,745,349	6,425,927	7,353,391
Total deferred inflow of resources	94,106	135,294	170,298
Net position:			
Net investment in capital assets	88,238	79,087	75,959
Restricted for debt service	305,780	310,324	263,381
Restricted for financial aid grant programs	29,305	52,079	61,478
Unrestricted	263,709	310,221	403,202
Total net position	\$ 687,032	751,711	804,020

Student loans receivable are net of the allowance for loan losses and the discount or premium on student loan purchases.

Student loan financings are net of the deferred gains (losses) on bond refundings and the discounts on student loan floating rate notes.

Results of Operations

Years ended June 30



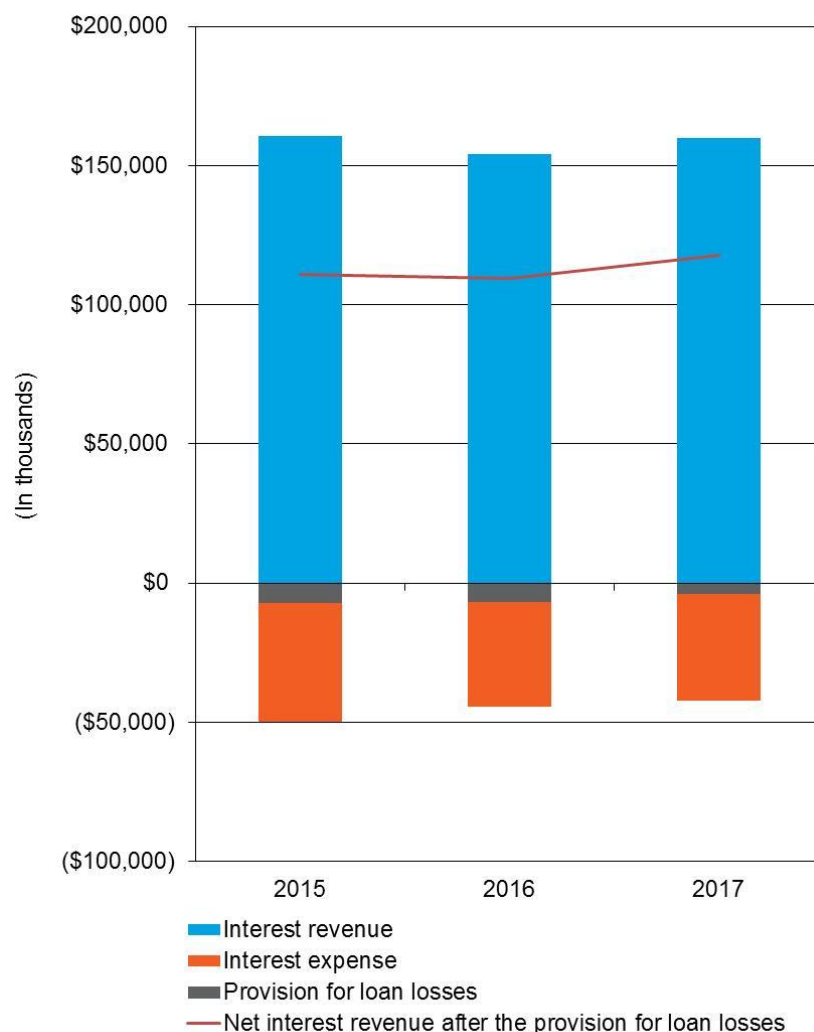
Operating income for the year ended June 30, 2017, was \$65.7 million, a 32.2% decrease from \$96.9 million in 2016. Operating revenues were \$636.6 million in 2017, a 1.8% increase from \$625.5 million in 2016. Net interest revenue after the provision for loan losses was \$117.6 million in 2017, a 7.3% increase from \$109.6 million in 2016. Noninterest revenue was \$519.0 million in 2017, a 0.6% increase from \$516.0 million in 2016. Operating expenses were \$570.9 million in 2017, an 8.0% increase from \$528.6 million in 2016.

Operating income for the year ended June 30, 2016, was \$96.9 million, a 12.6% decrease from \$110.9 million in 2015. Operating revenues were \$625.5 million in 2016, a 9.9% increase from \$569.2 million in 2015. Net interest revenue after the provision for loan losses was \$109.6 million in 2016, a 1.2% decrease from \$110.9 million in 2015. Noninterest revenue was \$516.0 million in 2016, a 12.6% increase from \$458.3 million in 2015. Operating expenses were \$528.6 million in 2016, a 15.3% increase from \$458.3 million in 2015.

A more detailed explanation of the results of operations follows.

Net Interest Revenue after the Provision for Loan Losses

Years ended June 30



Net interest revenue after the provision for loan losses results from the interest rate spread between our student loan and investment portfolios, and the associated financings to support those portfolios. In addition, we record a provision for loan losses to bring the allowance for loan losses to a level appropriate to absorb our estimate of probable incurred losses in the student loan portfolio.

For the year ended June 30, 2017, net interest revenue after the provision for loan losses was \$117.6 million, a 7.3% increase from \$109.6 million in 2016. The increase was mainly due to an increase in investment interest revenue and a decrease in the provision for loan losses, which was partially offset by a decrease in student loan interest revenue, net.

For the year ended June 30, 2016, net interest revenue after the provision for loan losses was \$109.6 million in 2016, a 1.2% decrease from \$110.9 million in 2015. The decrease was mainly due to a decrease in student loan interest revenue, net, which was partially offset by a decrease in the provision for loan losses and a decrease in interest expense on student loan financings, net.

A detailed explanation of the changes in net interest revenue after the provision for loan losses follows.



Net Interest Spread and Margin

The following table presents an analysis of our net interest spread and margin. Net interest spread is the difference between the interest earned on our revenue generating assets and the interest paid on our liabilities used to fund those assets. Net interest margin is the ratio of net interest revenue (total interest revenue minus total interest expense) to the average balance of the interest earning assets.

For the years ended June 30,	2017	2016	2015
Student loan yield	2.62%	2.30%	2.19%
Investment yield	1.54	0.64	0.55
Total interest yield	2.45	2.07	1.99
Student loan financing rate	(0.69)	(0.59)	(0.59)
Other financing rate	(1.32)	(1.37)	(1.41)
Total interest rate	(0.69)	(0.59)	(0.59)
Net interest spread	1.76%	1.48%	1.40%
Net interest margin	1.86%	1.56%	1.46%
Average balance (in thousands):			
Student loans	\$ 5,482,467	6,426,870	7,066,213
Investments	1,038,770	1,034,994	1,024,795
Student loan financings	5,480,187	6,370,538	7,134,015
Other financings	32,231	36,678	41,089

Rate and Volume Analysis

The amounts we earn as student loan interest revenue are based on fixed and variable rate student loans, and involve interpreting, and complying with complicated regulations issued by ED. ED makes special allowance payments, which are included in student loan interest revenue. ED calculates special allowance payments based on the type of loan, the date of the loan disbursement, the loan period, the loan status and a factor prescribed by law. ED calculates the special allowance rates using factors such as the 3-month financial commercial paper rate, 1-month LIBOR and 91-day Treasury bill rate.

As of June 30, 2017, the 91-day U.S. Treasury Bill rate was used to calculate special allowance for 3% of the student loan portfolio, the 3-month financial commercial paper rate was used to calculate special allowance for 14% of the student loan portfolio, and the 1-month LIBOR was used to calculate special allowance for 83% of the student loan portfolio.



The following rate and volume analysis shows the relative contribution of changes in interest rates and changes in volumes to changes in net interest revenue.

(Dollars in thousands)	2017 vs. 2016 Increase (decrease) attributable to change in			2016 vs. 2015 Increase (decrease) attributable to change in		
	Increase (decrease)	Rate	Volume	Increase (decrease)	Rate	Volume
For the years ended June 30						
Student loan interest revenue, net	\$ (3,723)	20,129	(23,852)	\$ (7,473)	3,909	(11,382)
Investment interest revenue:						
Investment income	3,512	3,494	18	989	949	40
Fair value adjustments	5,834	5,828	6	(53)	(70)	17
	5,623	29,451	(23,828)	(6,537)	4,788	(11,325)
Student loan financings interest expense, net	457	4,881	(4,424)	(4,734)	(267)	(4,467)
Other financings interest expense, net	(77)	(17)	(60)	(78)	(16)	(62)
	380	4,864	(4,484)	(4,812)	(283)	(4,529)
Net interest revenue	\$ 5,243	24,587	(19,344)	\$ (1,725)	5,071	(6,796)

2017 vs. 2016 – Changes in Rate and Volume

For the year ended June 30, 2017, the increase in the rate of our student loan interest revenue, net, was due to an increase in student loan yields, because of a decrease in the negative special allowance payments and the consolidation loan rebate fees paid by PHEAA. The decrease in the volume of our student loan interest revenue, net, was due to a decreasing student loan portfolio resulting from borrower payments, claim and consolidation payoffs.

For the year ended June 30, 2017, the increase in the rate of our investment income was due to an increase in the dividends earned from our investments at the Pennsylvania State Treasury. The increase in the rate of the fair value adjustments was mainly due to an increase in the Net Asset Value (NAV) of our investments at the Pennsylvania State Treasury.

For the year ended June 30, 2017, the increase in the rate of our student loan financings interest expense, net, was due to an increase in the 1-month LIBOR and 3-month LIBOR. The decrease in volume of our student loan interest expense, net, was due to payments made on our student loan financing debt.

2016 vs. 2015 – Changes in Rate and Volume

For the year ended June 30, 2016, the increase in the rate of our student loan interest revenue, net, was due to an increase in student loan yields, because of a decrease in the negative special allowance payments and the consolidation loan rebate fees paid by PHEAA. The decrease in the volume of our student loan interest revenue, net, was due to a decreasing student loan portfolio resulting from borrower payments.

For the year ended June 30, 2016, the increase in the rate of our investment income interest revenue was due to an increase in the returns earned on our investments at the Commonwealth of Pennsylvania Treasury.

For the year ended June 30, 2016, the decrease in volume of our student loan interest expense, net, was due to payments made on our student loan financing debt.



Provision for loan losses

The provision for loan losses is the expense necessary to maintain the allowance for loan losses at a level appropriate to absorb management's estimate of probable incurred losses inherent in the student loan portfolio.

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
Provision for losses	\$ 3,895	6,741	7,152

For the year ended June 30, 2017, the provision for loan losses was \$3.9 million, a 41.8% decrease from \$6.7 million in 2016. For the year ended June 30, 2016, the provision for loan losses was \$6.7 million, a 6.9% decrease from \$7.2 million in 2015. For the years ended June 30, 2017 and 2016, the decreases in the provision for loan losses were due to the write-off of non-performing loans.

See the "Allowance for Loan Losses" discussion under **Student Loans Receivable, net**, within the MD&A.

Noninterest Revenue

The following table displays the categories of noninterest revenue.

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
Servicing fees	\$ 321,350	324,664	307,922
Retention of collections on defaulted loans, net	174,538	170,809	130,975
Federal fees	17,275	18,922	20,634
Other	5,790	1,586	(1,194)
Total noninterest revenue	\$ 518,953	515,981	458,337

For the year ended June 30, 2017, total noninterest revenue was \$519.0 million, a 0.6% increase from \$516.0 million in 2016. For the year ended June 30, 2016, total noninterest revenue was \$516.0 million, a 12.6% increase from \$458.3 million in 2015.

In the sections that follow, we provide a more detailed explanation of the changes in total noninterest revenue.

Servicing Fees

Years ended June 30



We earn servicing fee revenue by servicing student loans owned by third parties. We categorize revenue earned from loans owned by ED as “FLS Servicing”; whereas we categorize revenue earned from loans owned by financial institutions and secondary markets as “Commercial Servicing”. Our Remote Servicing line of business provides our system to guarantors and other servicers to use, as well as to NFP servicers who were awarded servicing contracts by ED.

Total Servicing Fees

For the year ended June 30, 2017, total servicing fees were \$321.4 million, a 1.0% decrease from \$324.7 million in 2016. For the year ended June 30, 2017, the average third party loans serviced on our systems were \$372.6 billion, a 10.9% increase from \$336.0 billion in 2016.

For the year ended June 30, 2016, total servicing fees were \$324.7 million, a 5.5% increase from \$307.9 million in 2015. For the year ended June 30, 2016, the average third party loans serviced on our systems were \$336.0 billion, a 12.5% increase from \$298.7 billion in 2015.

In the sections that follow, we discuss the changes in total servicing fees.



FLS Servicing Fees

For the year ended June 30, 2017, FLS Servicing fees were \$194.9 million, a 3.4% increase from \$188.5 million in 2016. For the year ended June 30, 2017, the average FLS servicing portfolio of loans was \$282.1 billion, a 14.3% increase from \$246.8 billion in 2016. For the year ended June 30, 2017, the average number of total unique borrowers in-repayment in the FLS servicing portfolio was 3.2 million, a 14.3% increase from 2.8 million in 2016.

For the year ended June 30, 2016, FLS Servicing fees were \$188.5 million, a 12.5% increase from \$167.6 million in 2015. For the year ended June 30, 2016, the average FLS servicing portfolio of loans was \$246.8 billion, an 18.8% increase from \$207.8 billion in 2015. For the year ended June 30, 2016, the average number of total unique borrowers in-repayment in the FLS servicing portfolio was 2.8 million, a 16.7% increase from 2.4 million in 2015.

For the years ended June 30, 2017 and 2016, the increase in FLS Servicing fees was due to an increase in the average fee per borrower in the FLS servicing portfolio, as student loans mature and move into higher paying statuses, such as current repayment.

Commercial Servicing Fees

For the year ended June 30, 2017, Commercial Servicing fees were \$110.7 million, a 9.3% decrease from \$122.0 million in 2016. For the year ended June 30, 2017, the average Commercial Servicing portfolio of loans (excluding PHEAA owned loans) was \$38.2 billion, a 10.5% decrease from \$42.7 billion in 2016. For the year ended June 30, 2017, the decrease in Commercial Servicing fees was primarily due to a decrease in the volume of our commercial servicing portfolio.

For the year ended June 30, 2016, Commercial Servicing fees were \$122.0 million, a 3.4% decrease from \$126.3 million in 2015. For the year ended June 30, 2016, the average Commercial Servicing portfolio of loans (excluding PHEAA owned loans) was \$42.7 billion, a 4.3% decrease from \$44.6 billion in 2015. For the year ended June 30, 2016, the decrease in Commercial Servicing fees was primarily due to a decrease in the volume of our commercial servicing portfolio.

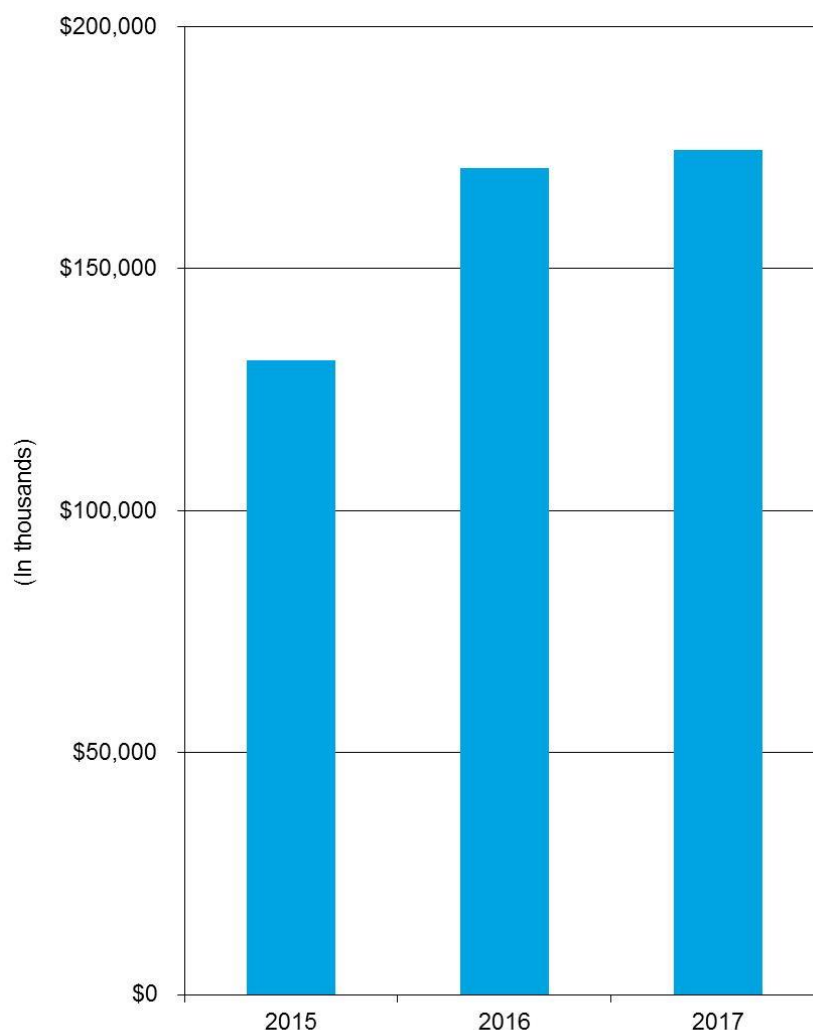
Remote Servicing Fees

For the year ended June 30, 2017, Remote Servicing fees were \$15.8 million, an 11.3% increase from \$14.2 million in 2016. For the year ended June 30, 2017, the average Remote Servicing portfolio of loans was \$52.3 billion, a 12.5% increase from \$46.5 billion in 2016. For the year ended June 30, 2017, the increase in Remote Servicing fees was primarily due to an increase in the volume of our Remote Servicers student loan servicing portfolio.

For the year ended June 30, 2016, Remote Servicing fees were \$14.2 million, a 1.4% increase from \$14.0 million in 2015. For the year ended June 30, 2016, the average Remote Servicing portfolio of loans, excluding the NFP Servicers, was \$12.4 billion, an 18.1% increase from \$10.5 billion in 2015. For the year ended June 30, 2016, the average portfolio of loans related to the NFP Servicers was \$34.1 billion, a 4.7% decrease from \$35.8 billion for the same period ended 2015. For the year ended June 30, 2016, the increase in Remote Servicing fees was primarily due to an increase in the volume of our Remote Servicers student loan servicing portfolio, excluding NFP Servicers, and one-time fees, which was offset by a decrease in the volume of our NFP Servicers student loan servicing portfolio.

Retention of Collections on Defaulted Loans, net

Years ended June 30



As a guarantor, we facilitate the guarantee of 97% - 100% of the borrower's outstanding loan balance depending on the disbursement date of the borrower's loan. The federal government reimburses the Federal Fund at 100% for all claims paid by the guarantor on or after December 1, 2015. Retention of collections on defaulted loan rates are based upon the Higher Education Act, as amended, and revenue is earned when collected. Lastly, in order to facilitate the sale of the rehabilitated student loans to eligible lenders, we purchase rehabilitated student loans and sell them to eligible lenders sometimes at a discount.

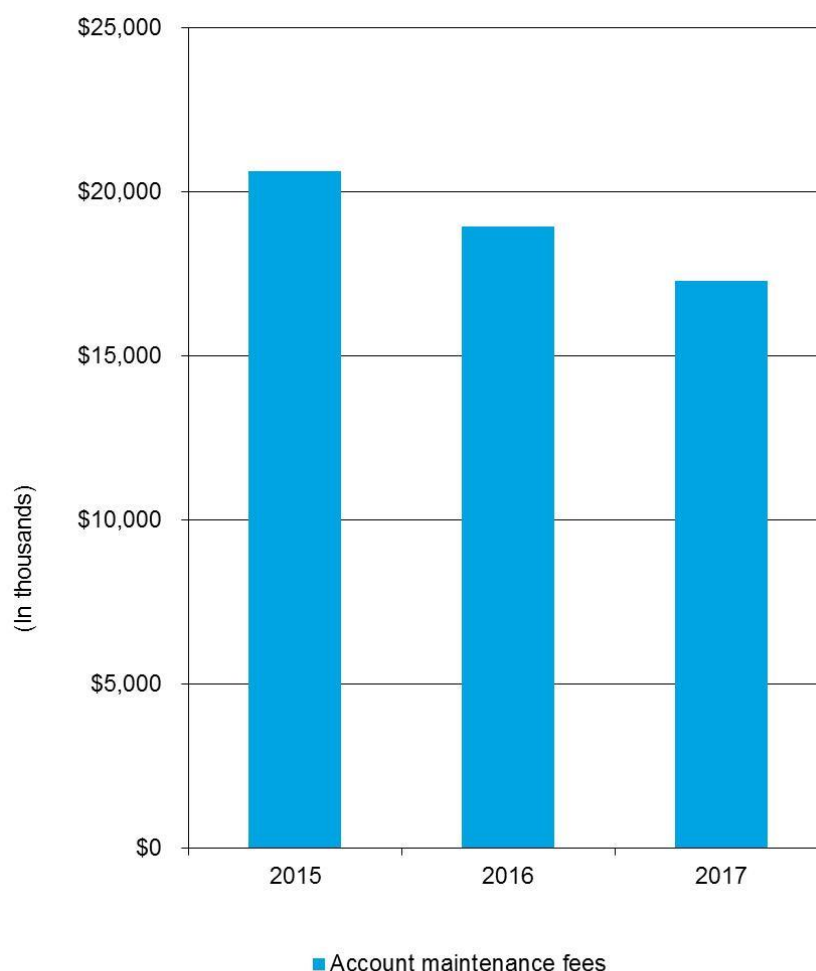
For the year ended June 30, 2017, the retention of collections on defaulted loans, net, was \$174.5 million, a 2.2% increase from \$170.8 million in 2016. For the year ended June 30, 2017, total collections on defaulted loans was \$1.1 billion, an 8.3% decrease from \$1.2 billion in 2016. The increase in the retention of collections on defaulted loans, net was due to an increase in the price offered to eligible lenders for purchasing rehabilitation loans, which was offset by a decrease in the total collections on defaulted loans.

For the year ended June 30, 2016, the retention of collections on defaulted loans, net, was \$170.8 million, a 30.4% increase from \$131.0 million in 2015. For the year ended June 30, 2016, total collections on defaulted loans was \$1.2 billion, a 22.6% increase from \$978.5 million in 2015. For the year ended June 30, 2016, the increase in the collections on defaulted loans, net, was due to an increase in the collections of rehabilitation loans, which was offset

by a decrease in the collections on direct consolidation loans and a decrease in the price offered to eligible lenders for purchasing rehabilitation loans.

Federal Fees

Years ended June 30



We earn account maintenance fees, which we classify as federal fees, from operating the guaranty agency. ED pays us an annual account maintenance fee that is 0.06% of the original principal amount of outstanding loans guaranteed as long as the guarantee remains in force.

For the year ended June 30, 2017, federal fees were \$17.3 million, an 8.5% decrease from \$18.9 million in 2016. For the year ended June 30, 2017, the average original principal balance of outstanding loans guaranteed was \$27.6 billion, a 9.5% decrease from \$30.5 billion in 2016.

For the year ended June 30, 2016, federal fees were \$18.9 million, an 8.3% decrease from \$20.6 million in 2015. For the year ended June 30, 2016, the average original principal balance of outstanding loans guaranteed was \$30.5 billion, a 9.2% decrease from \$33.6 billion in 2015.



For the years ended June 30, 2017 and 2016, the decrease in federal fees was mainly due to the decrease in the average original principal balance of outstanding loans guaranteed.

Operating Expenses

The following tables display our major categories of operating expenses.

(Dollars in thousands)

For the years ended June 30,	2017		2016		2015	
Personnel and benefits	\$	319,622 56.0%	\$	305,489 57.8%	\$	257,450 56.2%
Professional services		109,296 19.1%		97,073 18.4%		58,698 12.8%
Information technology		59,627 10.5%		50,828 9.6%		43,930 9.6%
Mail services		27,873 4.9%		32,588 6.2%		35,148 7.7%
Depreciation		16,758 2.9%		13,770 2.6%		11,789 2.5%
Other		37,747 6.6%		28,867 5.4%		51,271 11.2%
Total operating expenses	\$	570,923 100.0%	\$	528,615 100.0%	\$	458,286 100.0%

For the years ended June 30, 2017, operating expenses were \$570.9 million, an 8.0% increase from \$528.6 million in 2016. For the year ended June 30, 2016, operating expenses were \$528.6 million, a 15.3% increase from \$458.3 million in 2015.

In the sections that follow, we discuss changes in personnel and benefits, professional services, information technology and other expenses.

Personnel and Benefits

The following tables display personnel and benefits expenses:

(Dollars in thousands)

For the years ended June 30,	2017		2016		2015	
Compensation	\$	168,869 52.8%	\$	171,333 56.1%	\$	156,024 60.6%
Pension expense		79,651 24.9%		65,807 21.5%		41,662 16.2%
Healthcare benefits for employees and retirees		42,606 13.3%		42,440 13.9%		35,933 14.0%
Independent contractor fees		20,144 6.3%		16,019 5.2%		15,849 6.2%
Employer's share of Social Security		12,270 3.8%		12,487 4.1%		11,296 4.4%
Capitalized software development costs		(5,727) (1.7%)		(4,301) (1.4%)		(4,551) (1.8%)
Other		1,809 0.6%		1,704 0.6%		1,237 0.4%
Total personnel and benefits	\$	319,622 100.0%	\$	305,489 100.0%	\$	257,450 100.0%

For the year ended June 30, 2017, personnel and benefits costs were \$319.6 million, a 4.6% increase from \$305.5 million in 2016. For the year ended June 30, 2016, personnel and benefits costs were \$305.5 million, an 18.6% increase from \$257.5 million in 2015.

A discussion on the changes in personnel and benefit costs follows.



Pension expense

The Governmental Accounting Standards Board ("GASB") requires cost-sharing employers to recognize and report pension expense related to its proportionate share of collective pension expense. The employer's proportionate shares are determined using the employer's proportion to the collective net pension liability.

For the year ended June 30, 2017, pension expense was \$79.7 million, a 21.1% increase from \$65.8 million in 2016. For the year ended June 30, 2016, pension expense was \$65.8 million, a 57.8% increase from \$41.7 million in 2015. For the years ended June 30, 2017 and 2016, the increases in pension expense were due increases in the net amortization of deferred amounts from changes in our proportionate share. See **Note 9 – Retirement and Other Postemployment Benefits**, subtopic **SERS GASB 68 Valuation** for more details on our proportionate share of collective pension expense.

Independent Contractor Fees

For the year ended June 30, 2017, independent contractor fees were \$20.1 million, a 25.6% increase from \$16.0 million in 2016, which primarily relate to information technology and internal audit activities.

For the year ended June 30, 2016, independent contractor fees were \$16.0 million, a 1.3 % increase from \$15.8 million in 2015.

Professional Services

The following tables display professional services expenses:

(Dollars in thousands)

For the years ended June 30,	2017			2016		2015	
Collection agency fees	\$	41,267	37.8%	\$	46,066	47.5%	\$ 33,601 57.2%
Consulting fees		23,804	21.8%		20,215	20.8%	2,011 3.5%
Legal fees		15,641	14.3%		11,916	12.3%	14,106 24.0%
Data entry services		13,408	12.3%		6,148	6.3%	849 1.4%
Default aversion outsourcing fees		9,183	8.4%		8,380	8.6%	3,667 6.2%
Audit fees		2,531	2.3%		2,153	2.2%	2,438 4.2%
Other professional services		3,462	3.1%		2,195	2.3%	2,026 3.5%
Total professional services	\$	109,296	100.0%	\$	97,073	100.0%	\$ 58,698 100.0%

For the year ended June 30, 2017, professional services were \$109.3 million, a 12.6% increase from \$97.1 million in 2016. The increase in professional services was mainly due to an increase in data entry services resulting from outsourcing certain processing functions to third party vendors; an increase in legal fees associated with our on-going litigation; and an increase in consulting fees for information technology consultants.

For the year ended June 30, 2016, professional services were \$97.1 million, a 65.4% increase from \$58.7 million in 2015. The increase in professional services was mainly due to an increase in collection agency fees resulting from an increase in the total volume collected on defaulted loans by third party vendors; an increase in consulting fees due to an increase in information technology consultants; an increase in data entry services due to outsourcing certain processing functions to third party vendors; and a decrease in legal fees due to a prior period bond refunding.



Information Technology

The following tables display information technology expenses:

(Dollars in thousands)

For the years ended June 30,	2017		2016		2015	
PC software, licenses and rentals	\$	26,399	44.3%	\$ 20,824	41.0%	\$ 21,329 48.6%
Equipment purchases, rentals and maintenance		24,471	41.0%	22,603	44.5%	16,169 36.8%
Other information technology		8,757	14.7%	7,401	14.5%	6,432 14.6%
Total information technology	\$	59,627	100.0%	\$ 50,828	100.0%	\$ 43,930 100.0%

For the year ended June 30, 2017, information technology was \$59.6 million, a 17.3% increase from \$50.8 million in 2016. The increase in information technology was mainly due to an increase in license agreements and software purchases, mainframe lease upgrades, storage equipment upgrades and the renewal of maintenance agreements.

For the year ended June 30, 2016, information technology was \$50.8 million, a 15.7% increase from \$43.9 million in 2015. The increase in information technology was mainly due to an increase in equipment purchases and software maintenance.

Other

The following tables display other expenses:

(Dollars in thousands)

For the years ended June 30,	2017		2016		2015	
Bond issuance costs and bank fees	\$	11,395	30.2%	\$ 5,538	19.2%	\$ 12,916 25.2%
Buildings and grounds		7,341	19.4%	6,646	23.0%	7,093 13.8%
Telephone		7,332	19.4%	8,007	27.7%	6,506 12.7%
Printing expense		2,512	6.7%	2,771	9.6%	3,345 6.5%
Third party guarantor expense		2,045	5.4%	2,015	7.0%	2,052 4.0%
Net realizable value adjustment in amounts due from the Federal Fund		-	-	(3,614)	(12.5%)	14,289 27.9%
Other G&A		7,122	18.9%	7,504	26.0%	5,070 9.9%
Total other expenses	\$	37,747	100.0%	\$ 28,867	100.0%	\$ 51,271 100.0%

For the year ended June 30, 2017, other expenses were \$37.7 million, a 30.4% increase from \$28.9 million in 2016. The increase in other expenses was mainly due to an increase in bond issuance costs and bank fees and a reduction in the net realizable value adjustment in amounts due from the Federal Fund.

For the year ended June 30, 2017, bond issuance costs and bank fees were \$11.4 million, a 107.3% increase from \$5.5 million in 2016. The increase was due to bond issuance fees associated with the PHEAA Student Loan Trust 2016-1 bond issuance on September 14, 2016, the PHEAA Student Loan Trust 2016-2 bond issuance on November 22, 2016, and maintenance fees on our warehouse lines of credit. For the year ended June 30, 2016, there were no bond issuances.



For the year ended June 30, 2017, the net realizable value ("NRV") adjustment in amounts due from the Federal Fund was zero compared to a negative \$3.6 million in 2016. The change was due to the prior period in which we reversed \$4.0 million of NRV allowance, since we believed that amounts due to us from the Fed Fund were collectible.

For the year ended June 30, 2016, other expenses were \$28.9 million, a 43.7% decrease from \$51.3 million in 2015. For the year ended June 30, 2016, the decrease was due to a reduction in bond issuance costs as a result of no bond refundings during this period and a reduction in the NRV adjustment in amounts due from the Federal Fund since we believed amounts due to us from the Fed Fund were collectible.

Changes in Net Position

The following table shows the changes in net position:

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
Income before grants and financial aid	\$ 65,757	96,812	110,693
Commonwealth of Pennsylvania grants	334,695	365,359	403,616
Federal grants	1,608	1,587	1,572
Grants and other financial aid, net of refunds	(466,739)	(466,439)	(470,533)
Grant funds returned to the Commonwealth	-	(49,628)	-
Total grants and financial aid, net of refunds	(130,436)	(149,121)	(65,345)
Changes in net position	\$ (64,679)	(52,309)	45,348

Commonwealth of Pennsylvania Grants and Grant Funds Returned to the Commonwealth

For the year ended June 30, 2017, Commonwealth of Pennsylvania grants net of grant funds returned to the Commonwealth were \$334.7 million, a 6.0% increase from \$315.7 million in 2016. The increase was due to the prior period in which we initially received from the Commonwealth \$305.2 million in allocated funding for the Pennsylvania State Grant program, but as a result of House Bill 1801 we funded an additional \$39.0 million using our own earnings to the Pennsylvania State Grant program and returned the same amount of allocated funding to the Commonwealth.

For the year ended June 30, 2016, Commonwealth of Pennsylvania grants net of grant funds returned to the Commonwealth were \$315.7 million, a 21.8% decrease from \$403.6 million in 2015. The decrease was mainly due to the Commonwealth allocating fewer funds to the Pennsylvania State Grant program and requiring PHEAA to make up for the shortfall in the Commonwealth's allocation. For the year ended June 30, 2016, the Commonwealth allocated \$266.2 million to the Pennsylvania State Grant program, a 22.8% decrease from \$344.9 million in 2015. For the year ended June 30, 2016, we contributed \$125.0 million to the Pennsylvania State Grant program, a 66.7% increase from \$75.0 million in 2015.



Grants and Other Financial Aid Activity, net

The following table shows the changes within "Grants and other financial aid activity, net".

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
Pennsylvania State Grant Program, net of refunds	\$ 384,669	392,902	401,339
Institutional Assistance Grant Program, net of refunds	26,285	24,495	24,643
Pennsylvania National Guard Education Assistance Program, net of refunds	13,140	12,488	11,828
Pennsylvania Distance Education Program, net of refunds	12,974	10,323	7,313
Matching Funds Grant Program, net of refunds	11,813	11,566	11,914
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program, net of refunds	6,990	4,886	4,373
Pennsylvania Ready to Succeed Scholarship Program, net of refunds	5,077	5,019	4,806
Higher Education for the Disadvantaged Program, net of refunds	2,006	2,283	2,537
Other Programs, net of refunds	3,785	2,477	1,780
Total grants and other financial aid, net	\$ 466,739	466,439	470,533

For the year ended June 30, 2017, grants and other financial aid, net, were \$466.7 million, a 0.1% increase from \$466.4 million during 2016. For the year ended June 30, 2016, grants and other financial aid, net of refunds, were \$466.4 million, a 0.9% decrease from \$470.5 million during 2015.

For the years ended June 30, 2017 and 2016, the changes in grants and other financial aid, net of refunds, were primarily due to the timing of funds disbursed from various grant programs.



Student Loan Receivables, net

In the table below, we present our student loan receivables, net.

(Dollars in thousands)

As of June 30,	2017	2016	2015
FFEL student loans:			
Consolidation	\$ 4,057,477	4,705,793	5,396,113
Stafford	849,572	1,074,457	1,325,486
PLUS	75,457	104,978	142,308
Supplemental Loans for Students (SLS)	812	987	1,293
Total FFEL student loans	4,983,318	5,886,215	6,865,200
Private and HEAL student loans:			
Private	20,133	28,789	34,355
HEAL	19,103	27,974	37,689
Total private and HEAL student loans	39,236	56,763	72,044
Total student loans receivable	5,022,554	5,942,978	6,937,244
Unamortized premium on student loan purchases	5,559	8,203	10,434
Unamortized discount on student loan purchases	(8,308)	(11,913)	(12,672)
Allowance for loan losses	(6,646)	(21,229)	(20,871)
Total student loan receivables, net	\$ 5,013,159	5,918,039	6,914,135

As of June 30, 2017, student loan receivables, net, were \$5.0 billion, a 15.3% decrease from \$5.9 billion in 2016. As of June 30, 2017, the decrease in student loan receivables, net, was mainly due to borrower payments, claim and consolidation payoffs.

As of June 30, 2016, student loan receivables, net, were \$5.9 billion, a 14.5% decrease from \$6.9 billion in 2015. As of June 30, 2016, the decrease in student loan receivables, net, was mainly due to borrower payments.

A discussion on the student loan delinquency trends and the allowance for loan losses follows.



Delinquencies have the potential to adversely affect earnings through increased collection costs and charge-offs/write-offs. The June 30, 2017 table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include \$136 thousand of student loans categorized as non-performing, \$2.6 million of student loans categorized as uninsured, \$94 thousand of student loans with credit balances and \$56 thousand of student loan payments in-process.

(Dollars in thousands)

As of June 30, 2017	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	\$	4,103	\$	41	\$	4,144
Loans in deferment and forbearance:						
Deferment		313,911		886		314,797
Forbearance		433,944		354		434,298
Total loans in-school/in-grace, and deferment and forbearance	\$	751,958	\$	1,281	\$	753,239
Loans in repayment:						
Current	\$	3,748,866	88.7%	\$ 35,915	95.0%	\$ 3,784,781 88.7%
31 – 60 days		148,060	3.5%	811	2.2%	148,871 3.5%
61 – 90 days		91,076	2.1%	282	0.7%	91,358 2.1%
91 – 120 days		50,764	1.2%	61	0.2%	50,825 1.2%
121 – 180 days		83,982	2.0%	29	0.1%	84,011 2.0%
181 – 270 days		72,316	1.7%	43	0.1%	72,359 1.7%
271 days or greater		25,877	0.6%	146	0.4%	26,023 0.6%
Claims filed not paid		7,882	0.2%	501	1.3%	8,383 0.2%
Total loans in repayment	\$	4,228,823	100.0%	\$ 37,788	100.0%	\$ 4,266,611 100.0%



The June 30, 2016 table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include \$6.5 million of student loans categorized as non-performing, \$4.1 million of student loans categorized as uninsured and \$72 thousand of student loans with credit balances.

(Dollars in thousands)

As of June 30, 2016	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	\$	7,814	\$	67	\$	7,881
Loans in deferment and forbearance:						
Deferment		428,490		1,336		429,826
Forbearance		589,672		683		590,355
Total loans in-school/in-grace, and deferment and forbearance	\$	1,025,976	\$	2,086	\$	1,028,062
Loans in repayment:						
Current	\$	4,281,724	88.2%	\$ 47,558	92.2%	\$ 4,329,282 88.3%
31 – 60 days		180,416	3.7%	1,231	2.4%	181,647 3.7%
61 – 90 days		107,048	2.2%	313	0.6%	107,361 2.2%
91 – 120 days		63,476	1.3%	168	0.3%	63,644 1.3%
121 – 180 days		97,769	2.0%	74	0.1%	97,843 2.0%
181 – 270 days		84,285	1.7%	57	0.1%	84,342 1.7%
271 days or greater		27,962	0.6%	887	1.7%	28,849 0.6%
Claims filed not paid		10,140	0.3%	1,292	2.6%	11,432 0.2%
Total loans in repayment	\$	4,852,820	100.0%	\$ 51,580	100.0%	\$ 4,904,400 100.0%

Allowance for Loan Losses

Allowances for potential losses on our student loans can result from deficient servicing, risk sharing on defaulted and uninsured loans. These allowances are based upon our ongoing evaluation of the loan portfolios, past and anticipated loss experience and the amount and quality of the loans. We maintain the allowances at a level that we believe is adequate to absorb estimated incurred losses, but our evaluation is inherently subjective and the required allowances may significantly change in the future.

FFEL Program Loans

The allowance for loan losses-FFEL program loans represents our estimate of the costs related to the risk sharing on FFEL program loans only. This allowance does not include the risk associated with non-FFEL program loans. The allowance for loan losses-FFEL program loans along with the allowance for loan losses-other program loans (Non-FFEL) are included in the section titled "Allowance for loan losses" in **Note 6 – Student Loans Receivable, net**.

We report the allowance for loan losses-FFEL program loans in the table that follows along with the allowance for loan losses-other program loans (Non-FFEL) in "Student loans receivable, net" in the Statements of Net Position. The provision for loan losses on FFEL student loans in the table that follows along with the provision for loan losses on non-FFEL program loans are included in the "provision for losses" in the Statements of Revenues, Expenses and Changes in Net Position.



(Dollars in thousands)

As of June 30,	2017	2016	2015
Balance at beginning of period	\$ 16,599	15,100	14,557
Provision for losses	3,228	7,882	6,536
Charge-offs/Write-offs	(13,532)	(6,383)	(5,993)
Balance at end of period	\$ 6,295	16,599	15,100
Ending balance of FFEL student loans	\$ 4,983,318	5,886,215	6,865,200
Allowance as a percentage of ending balance of student loans	0.13%	0.28%	0.22%

As of June 30, 2017, the allowance for loan losses-FFEL program loans was \$6.3 million, a 62.0% decrease from \$16.6 million in 2016. The decrease in allowance for loan losses-FFEL program loans was due to a write-off of non-performing student loans. As of June 30, 2017, we believe the allowance for loan losses-FFEL program loans is adequate to cover the inherent losses on our FFEL student loan portfolio. The change in the provision for loan losses was discussed previously in the section titled “**Net Interest Revenue after the Provision for Loan Losses**”.

As of June 30, 2016, the allowance for loan losses-FFEL program loans was \$16.6 million, a 9.9% increase from \$15.1 million in 2015. The increase in the allowance for loan losses-FFEL program loans was due to an increase in claim payments.

Other Program Loans (Non-FFEL)

The allowance for loan losses-other program loans (Non-FFEL) represents our estimate of the risk associated with non-FFEL program loans, such as private and cure loans.

We report the allowance for loan losses-other program loans (Non-FFEL) in the table that follows along with the allowance for loan losses-FFEL program loans within “Student loans receivable, net” within the Statements of Net Position. The provision for loan losses on non-FFEL student loans in the table that follows along with the provision for loan losses on FFEL program loans are included in the “provision for losses” in the Statements of Revenues, Expenses and Changes in Net Position.

(Dollars in thousands)

As of June 30,	2017	2016	2015
Balance at beginning of period	\$ 4,630	5,771	5,155
Provision for losses	667	(1,141)	616
Charge-offs/Write-offs	(4,946)	-	-
Balance at end of period	\$ 351	4,630	5,771
Ending balance of non-FFEL student loans	\$ 39,236	56,763	72,044
Allowance as a percentage of ending balance of student loans	0.89%	8.16%	8.01%

As of June 30, 2017, the allowance for loan losses-other program (Non-FFEL) was \$351 thousand, a 92.4% decrease from \$4.6 million in 2016. The decrease in allowance for loan losses-other program loans (Non-FFEL) was due to the write-off of non-performing loans. As of June 30, 2017, we believe the allowance for loan losses-other program loans (Non-FFEL) is adequate to cover the inherent losses on our non-FFEL student loan portfolio. The change in the provision for loan losses was discussed previously in the section titled “**Net Interest Revenue after the Provision for Loan Losses**”.



As of June 30, 2016, the allowance for loan losses-other program (Non-FFEL) was \$4.6 million, a 20.7% decrease from \$5.8 million in 2015. The decrease in the allowance for loan losses-other program (Non-FFEL) was due to the write-off of non-performing loans.

Debt Activity and Capital Assets

Debt Activity

The schedule that follows contains select information from the Statements of Net Position, which relate to our debt activity.

(Dollars in thousands)

As of June 30,	2017	2016	2015
Deferred outflow of resources:			
Deferred loss on bond refundings	\$ 841	1,299	2,013
Current liabilities:			
Student loan financings	\$ 200,000	938,213	903,779
Other financings	4,055	3,895	3,745
Long-term liabilities:			
Student loan financings, net	\$ 4,762,797	4,751,841	5,852,233
Other financings, net	26,099	30,734	35,290
Deferred inflow of resources:			
Deferred gain on bond refundings	\$ 82,247	134,067	168,779

Our enabling legislation imposes a debt limit, which states that the aggregate principal amount of bonds, notes and similar evidences of indebtedness of the Agency shall not exceed twenty percent (20%) of the total of loans purchased, made or guaranteed by PHEAA.

As of June 30, 2017, our outstanding debt, excluding our blended component units, the deferred gain and loss on bond refundings, premiums and discounts on bonds, amounted to \$843.2 million, which was below the 20% threshold mentioned above. The blended component units are excluded from this threshold, because their debt was not issued by PHEAA. As of June 30, 2017, the outstanding debt of our blended component units was \$4.2 billion, which was related to the student loan trusts.

As of June 30, 2016, our outstanding debt, excluding our blended component units, the deferred gain and loss on bond refundings, premiums and discounts on bonds, amounted to \$1.2 billion, which was below the 20% threshold mentioned above. The blended component units are excluded from this threshold, because their debt was not issued by PHEAA. As of June 30, 2016, the outstanding debt of our blended component units was \$4.6 billion, which was related to the student loan trusts.

See **Note 12 – Blended Component Units** for more details on the student loan trusts.



The following tables show the financing (bond market and financial institutions) of our debt activity.

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
<u>Capital market activity</u>			
Proceeds from issuing student loan floating rate notes	\$ 925,568	-	1,279,519
Repayment of student loan floating rate notes	(873,723)	(853,142)	(838,030)
Repayment of student loan auction rate security bonds	(45,050)	(50,200)	(1,412,800)
<u>Student loan financing activity</u>			
Proceeds from student loan financings	\$ -	-	1,649,158
Repayment of student loan financings	(738,213)	(165,566)	(989,519)
<u>Other financing activity</u>			
Repayment of capital acquisition refunding bonds	\$ (3,895)	(3,745)	(3,660)

2017 Debt Activity

Capital Market Activity & Student Loan Financing Activity

For the year ended June 30, 2017, the \$925.6 million of student loan floating rate note proceeds were due to the PHEAA Student Loan Trust 2016-1 bond issuance on September 14, 2016 and the PHEAA Student Loan Trust 2016-2 bond issuance on November 22, 2016.

For the year ended June 30, 2017, the \$918.8 million of capital market activity repayments were due to required debt payments.

For the year ended June 30, 2017, the \$738.2 million of student loan financings repayments were due to the pay down of the warehouse lines of credit as a result of the PHEAA Student Loan Trust 2016-1 and the PHEAA Student Loan Trust 2016-2 bond issuances mentioned above and required debt payments.

Other Financing Activity

For the year ended June 30, 2017, the \$3.9 million in other financing activity repayments was due to required principal and interest payments on the Capital Acquisition Refunding Bonds, Series of 2012.

See **Note 8 – Notes and Bonds Payable and Other Financings** for more details on the above debt activity.

2016 Debt Activity

Capital Market Activity & Student Loan Financing Activity

For the year ended June 30, 2016, the \$903.3 million in the capital market activity repayments was due to required debt payments.

For the year ended June 30, 2016, the \$165.6 million in the student loan financing activity repayments was due to the repayment of funds on our warehouse lines of credit.

Other Financing Activity

For the year ended June 30, 2016, the \$3.7 million in other financing activity repayments was due to required principal and interest payments on the Capital Acquisition Refunding Bonds, Series of 2012.

Capital Assets

The following table shows our capital assets, net of accumulated depreciation and amortization, except for land, which is a non-depreciable asset.

(Dollars in thousands)

As of June 30,	2017	2016	2015
Land	\$ 8,038	8,038	8,038
Buildings and improvements, net	31,664	33,082	33,371
Software, net (purchased and developed)	30,326	21,027	18,111
IT equipment, net	12,018	9,824	8,663
Other, net	6,192	7,116	7,776
Total capital assets, net	\$ 88,238	79,087	75,959

As of June 30, 2017, capital assets, net of accumulated depreciation and amortization, were \$88.2 million, an 11.5% increase from \$79.1 million as of June 30, 2016. The increase in capital assets, net of accumulated depreciation and amortization, was mainly due to the purchase of software and IT equipment.

As of June 30, 2016, capital assets, net of accumulated depreciation and amortization, were \$79.1 million, a 4.1% increase from \$76.0 million as of June 30, 2015. The increase in capital assets, net of accumulated depreciation and amortization, was mainly due to purchased software.

Net Position

The following table shows our restricted and unrestricted net position.

(Dollars in thousands)

As of June 30,	2017	2016	2015
Net investment in capital assets	\$ 88,238	79,087	75,959
Restricted for debt service	305,780	310,324	263,381
Restricted for financial aid grant programs	29,305	52,079	61,478
Unrestricted	263,709	310,221	403,202
Total net position	\$ 687,032	751,711	804,020

Net investment in capital assets

We have net position that is invested in capital assets that includes land, buildings and improvements, software, information technology equipment, and other tangible assets that are used in our operations and that have initial useful lives extending beyond a single reporting period. These capital assets are net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

As of June 30, 2017, the net investment in capital assets was \$88.2 million, an 11.5% increase from \$79.1 million as of June 30, 2016. The increase in net investment in capital assets was mainly due to purchased software and IT equipment.



As of June 30, 2016, the net investment in capital assets was \$79.1 million, a 4.1% increase from \$76.0 million as of June 30, 2015. The increase in net investment in capital assets was mainly due to purchased software.

Restricted for debt service

We have net position restricted for debt service that is held under various indentures related to financing our student loan portfolios.

As of June 30, 2017, we had net position restricted for debt service of \$305.8 million, a 1.5% decrease from \$310.3 million as of June 30, 2016. The decrease in net position restricted for debt service was due to \$64.2 million of operating income restricted for debt service, which was offset by \$68.7 million of transfers to unrestricted net position. See **Note 11 - Segment Information** for more details.

As of June 30, 2016, we had net position restricted for debt service of \$310.3 million, a 17.8% increase from \$263.4 million as of June 30, 2015. The increase in net position restricted for debt service was due to \$64.2 million of operating income restricted for debt service, which was offset by \$17.2 million of transfers to unrestricted net position.

Restricted for financial aid grant programs

We have net position restricted for financial aid grant programs, because of the Commonwealth of Pennsylvania grants and federal grants that relate to specific programs. This net position is restricted until we disburse program-related grants.

As of June 30, 2017, we had net position restricted for financial aid grant programs of \$29.3 million, a 43.8% decrease from \$52.1 million as of June 30, 2016. The decrease in net position restricted for financial aid grant programs was mainly due to \$680.2 thousand of operating income restricted for financial aid grant programs, \$336.2 million of grant funding received from the Commonwealth and the federal government, and \$87.0 million of transfers from the Pennsylvania State Grant Fund (unrestricted), which were offset by \$446.7 million of grant disbursements, net of refunds.

As of June 30, 2016, we had net position restricted for financial aid grant programs of \$52.1 million, a 15.3% decrease from \$61.5 million as of June 30, 2015. The decrease in net position restricted for financial aid grant programs was mainly due to \$902.5 thousand of operating income restricted for financial aid grant programs, \$366.9 million of grant funding, \$125.0 million of transfers from the Pennsylvania State Grant Fund (unrestricted), which was offset by \$451.1 million of grant disbursements, net of refunds, \$49.6 million of grant funds returned to the Commonwealth, \$1.3 million of transfers to the Pennsylvania Distance Education Program fund (unrestricted) and \$228 thousand of transfers from the Pennsylvania Higher Education Foundation fund to PHEAA's Discretionary Fund (unrestricted).

Unrestricted

Under Commonwealth law, our statutory purpose is to increase higher education opportunities for Pennsylvania residents. Net position that we report as unrestricted is statutorily restricted to our purpose. The Higher Education Act Amendments of 1998 also restrict our use of net position related to FFEL guaranty activities to fulfilling our guaranty responsibilities and other student financial aid related activities selected by us. Because that restriction is consistent with our statutory purpose, we consider net position related to those activities to be unrestricted.

As of June 30, 2017, we had unrestricted net position of \$263.7 million, a 15.0% decrease from \$310.2 million as of June 30, 2016. The decrease in unrestricted net position was due to \$68.7 million of funds transferred from net position restricted for debt service, and unrestricted operating income of \$847.6 thousand, which was offset by \$87.0 million of transfers to net position restricted for financial aid grant programs, \$20.0 million of net grant disbursements, and \$9.1 million of funds transferred to net investment in capital assets.



As of June 30, 2016, we had unrestricted net position of \$310.2 million, a 23.1% decrease from \$403.2 million as of June 30, 2015. The decrease in unrestricted net position was due to unrestricted operating income of \$31.8 million, \$17.2 million of funds transferred from net position restricted for debt service, \$1.3 million of funds transferred from the Pennsylvania State Grant Program (restricted for financial aid grant programs) to the Pennsylvania Distance Education Program fund, \$228 thousand of funds transferred from the Pennsylvania Higher Education Foundation (restricted for financial aid grant programs) to the PHEAA Discretionary Fund, which was offset by \$125.0 million of funds transferred to the Pennsylvania State Grant program, \$15.3 million of net grant disbursements and \$3.2 million of funds transferred to net investment in capital assets.

Federal Student Loan Reserve Fund (Federal Fund)

We manage the Federal Fund solely for our activities as a guarantor under the FFEL program. We pay claims on defaulted loans out of the Federal Fund, which belongs to the federal government. The assets of the Federal Fund and the earnings on those assets are, at all times, the property of the United States government. We must exercise the level of care required of a fiduciary charged with the duty of protecting, investing, and administering the money of others.

The following table shows the changes in net position in the Federal Fund.

(Dollars in thousands)

For the years ended June 30,	2017	2016	2015
Additions			
Collections on defaulted loans	\$ 978,340	1,023,342	765,731
Reinsurance from the U.S. Department of Education	937,958	1,010,666	1,139,315
Transfers of guarantee reserves	-	-	(3)
Net appreciation in fair value of investments	144	79	36
Total additions	1,916,442	2,034,087	1,905,079
Deductions			
Purchases of defaulted loans from lenders	934,470	1,023,336	1,181,082
Reimbursement to U.S. Department of Education for federal share of defaulted loans collections	743,708	779,537	603,212
Reimbursement to PHEAA for our retention of defaulted loans collections	203,123	207,316	96,456
Default aversion fees, net	7,920	9,579	9,306
Total deductions	1,889,221	2,019,768	1,890,056
Net increase (decrease)	27,221	14,319	15,023
Net liabilities, beginning of period	(172,499)	(186,818)	(201,841)
Net liabilities, end of period	\$ (145,278)	(172,499)	(186,818)

For the year ended June 30, 2017, collections on defaulted loans were \$978.3 million, a 2.2% decrease from \$1.0 billion in 2016. For the year ended June 30, 2017, purchases of defaulted loans were \$934.5 million, an 6.6% decrease from \$1.0 billion in 2016.

For the year ended June 30, 2016, collections on defaulted loans were \$1.0 billion, a 30.6% increase from \$765.7 million in 2015. For the year ended June 30, 2016, purchases of defaulted loans were \$1.0 billion, a 16.7% decrease from \$1.2 billion in 2015.



Under the Higher Education Act of 1965, as amended, Section 428(c)(9)(A), we are required to maintain a current minimum reserve level of at least 0.25% of the total attributable amount of all outstanding loans guaranteed. Historically, ED has calculated this ratio at September 30, which is the close of the federal fiscal year, based upon regulatory reports that we file with ED.

On December 10, 2014, Federal Student Aid, an office of ED, issued a letter informing Guaranty Agencies of the changes ED made to certain reporting requirements for federal fiscal year 2015. One of the changes made was the methodology for calculating the minimum Federal Reserve Ratio, because the previous methodology did not meet statutory goals. Beginning with federal fiscal year 2015, the minimum Federal Reserve Ratio is calculated without adding allowances and other non-cash charges back to the Federal Fund. The minimum Federal Reserve Ratio is calculated as follows: Federal Fund Balance (Form 2000 AR26) divided by Original Principal Outstanding.

The table that follows displays our calculation of the Federal Reserve Ratio. The gain contingencies included in the following table reflects the projected future cash receipts to the Federal Fund based on current claims paid to date, which cannot be recognized under generally accepted accounting principles. The gain contingencies and adjustments displayed in the following table were agreed to in a management plan approved by ED on May 22, 2007.

(Dollars in thousands)	As of June 30, 2017	As of September 30, 2016
Generally accepted accounting principles – net position	\$ (145,278)	(165,425)
Gain contingency – default aversion fee rebate payable from PHEAA to the Federal Fund	7,917	6,108
Gain contingency – collections complement on future default collections	73,351	73,182
Default aversion fees payable to PHEAA, but not transferred from the Federal Fund to PHEAA	191,795	191,892
Federal Fund balance	\$ 127,785	105,757
Original principal outstanding	\$ 26,125,091	28,345,419
Federal reserve ratio	0.49%	0.37%
Minimum federal reserve ratio	0.25%	0.25%

See **Note 4 – Federal Student Loan Reserve Fund (Federal Fund) and Assets Held for the U.S. Department of Education** for more details on the net position held by us for ED in the Federal Fund.

Contacting Us

If you have questions about this report, please contact our Financial Management Division at 1200 N. 7th Street, Harrisburg, PA 17102.

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September 21, 2017



	2017	2016
<u>Operating revenues and expenses</u>		
<u>Interest revenue</u>		
Student loans, net	\$ 143,789	147,512
Investments	15,961	6,615
Total interest revenue	159,750	154,127
<u>Interest expense</u>		
Student loan financings, net	37,781	37,324
Other financings, net	425	502
Total interest expense	38,206	37,826
Net interest revenue	121,544	116,301
Provision for loan losses	(3,895)	(6,741)
Net interest revenue after provision for loan losses	117,649	109,560
<u>Noninterest revenue</u>		
Servicing fees	321,350	324,664
Retention of collections on defaulted loans, net	174,538	170,809
Federal fees	17,275	18,922
Other	5,790	1,586
Total noninterest revenue	518,953	515,981
Operating revenues	636,602	625,541
<u>Operating expenses</u>		
Personnel and benefits	319,622	305,489
Professional services	109,296	97,073
Information technology	59,627	50,828
Mail services	27,873	32,588
Depreciation	16,758	13,770
Other	37,747	28,867
Total operating expenses	570,923	528,615
Operating income	65,679	96,926
<u>Non-operating gains</u>		
Gain (loss) on sale of fixed assets	78	(114)
Income before grants and financial aid	65,757	96,812
<u>Grants and financial aid</u>		
Commonwealth of Pennsylvania grants	334,695	365,359
Federal grants	1,608	1,587
Grants and other financial aid, net of refunds	(466,739)	(466,439)
Grant funds returned to the Commonwealth of Pennsylvania	-	(49,628)
Total grants and financial aid, net of refunds	(130,436)	(149,121)
Changes in net position	(64,679)	(52,309)
Net position, beginning of period	751,711	804,020
Net position, end of period	\$ 687,032	751,711

See accompanying notes to financial statements.

Statements of Net Position
As of June 30,
(Dollars in thousands)



	2017	2016
Current assets:		
Cash and cash equivalents	\$ 126,142	72,713
Restricted cash and cash equivalents	312,787	223,188
Restricted cash and cash equivalents – due to customers	84,592	72,256
Investments	544,638	531,706
Restricted investments	28,999	50,661
Student loans receivable	788,882	962,917
Interest income receivable	72,897	77,964
Due from Federal Student Loan Reserve Fund, net	15,012	37,074
Federal Student Loan Reserve Fund assets held for U.S. Department of Education., net	60,657	55,533
Other assets	44,556	66,586
Total current assets	2,079,162	2,150,598
Long-term assets:		
Student loans receivable, net	4,224,277	4,955,122
Capital assets, net	88,238	79,087
Total long-term assets	4,312,515	5,034,209
Total assets	6,391,677	7,184,807
Deferred outflow of resources:		
Deferred outflows of resources related to pensions	133,969	126,826
Deferred loss on bond refundings	841	1,299
Total deferred outflow of resources	134,810	128,125
Current liabilities:		
Accounts payable and accrued expenses	193,268	183,456
Student loan financings	200,000	938,213
Amounts related to the Federal Student Loan Reserve Fund	60,657	55,533
Other financings	4,055	3,895
Total current liabilities	457,980	1,181,097
Long-term liabilities:		
Student loan financings, net	4,762,797	4,751,841
Net pension liability	474,743	440,673
Other financings, net	26,099	30,734
Accrued expenses	23,730	21,582
Total long-term liabilities	5,287,369	5,244,830
Total liabilities	5,745,349	6,425,927
Deferred inflow of resources:		
Deferred gain on bond refundings	82,247	134,067
Deferred inflows of resources related to pensions	11,601	872
Deferred gain on sales leaseback	258	355
Total deferred inflow of resources	94,106	135,294
Net position:		
Net investment in capital assets	88,238	79,087
Restricted for debt service	305,780	310,324
Restricted for financial aid grant programs	29,305	52,079
Unrestricted	263,709	310,221
Total net position	\$ 687,032	751,711

See accompanying notes to financial statements.



	2017	2016
<u>Cash flows from operating activities</u>		
Interest received on student loans	\$ 80,058	70,111
Principal received on student loans	933,451	1,124,014
Student loan purchases	(812,138)	(847,994)
Student loan sales, including net gains and losses	836,309	808,344
Servicing fees	343,111	307,621
Retention of collections on defaulted loans	196,632	203,887
Federal fees	17,708	19,355
Default aversion fee rebates	(1,247)	(902)
Other	351	829
Payment of operating expenses	(490,483)	(452,869)
Net cash provided by operating activities	1,103,752	1,232,396
<u>Cash flows from noncapital financing activities</u>		
Proceeds from the issuance of noncapital debt	925,568	-
Principal paid on noncapital debt	(1,660,881)	(1,072,653)
Interest paid on noncapital debt	(85,431)	(70,081)
Bond issuance costs	(8,164)	(2,066)
Commonwealth of Pennsylvania grants received	334,695	365,359
Federal grants received	1,608	1,587
Grants and financial aid paid	(466,739)	(466,439)
Grant funds returned to the Commonwealth of Pennsylvania	-	(49,628)
Net cash used for noncapital financing activities	(959,344)	(1,293,921)
<u>Cash flows from capital and related financing activities</u>		
Purchases of capital assets and development of software, net of disposals	(25,927)	(17,109)
Net cash used for capital and related financing activities	(25,927)	(17,109)
<u>Cash flows from investing activities</u>		
Proceeds from sales and maturities of investments	813,383	832,104
Purchases of investments	(797,191)	(790,474)
Interest received on investments	8,355	4,916
Net cash provided by investing activities	24,547	46,546
Net change in cash and cash equivalents (including restricted cash)	143,028	(32,088)
Cash and cash equivalents (including restricted cash), beginning of period	295,901	327,989
Cash and cash equivalents (including restricted cash), end of period	\$ 438,929	295,901

(continued)



	2017	2016
<u>Reconciliation of operating income to net cash provided by operating activities</u>		
Operating income	\$ 65,679	96,926
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	16,758	13,770
Interest paid on noncapital debt	85,432	70,081
Investment interest	(15,961)	(6,615)
Bond issuance costs	8,164	2,066
Pension expense valuation adjustment	37,657	29,733
Amortization of premium on loan purchases	2,644	2,229
Amortization of deferred gain on bond refunding	(51,362)	(33,998)
Amortization of deferred discount on bonds payable	4,161	2,950
Amortization of deferred premium on other financings	(580)	(661)
Changes in assets and liabilities:		
Decrease in interest income receivable	5,207	16,759
Decrease in student loans receivable	902,236	993,867
Decrease in amounts due from Federal Student Loan Reserve Fund	22,062	32,275
Decrease (increase) in other assets	22,030	(19,109)
(Decrease) increase in accounts payable and accrued expenses	(375)	32,123
Total adjustments	1,038,073	1,135,470
Net cash provided by operating activities	\$ 1,103,752	1,232,396

See accompanying notes to financial statements.



Note 1 – About PHEAA

Organization

The Pennsylvania Higher Education Assistance Agency (“PHEAA”), doing business as American Education Services (“AES”) and FedLoan Servicing (“FLS”), is a public corporation and government instrumentality created by the Pennsylvania General Assembly on August 7, 1963. Our mission is to improve higher education opportunities for Pennsylvanians.

The Commonwealth of Pennsylvania (“Commonwealth”) presents our financial information as a discretely presented component unit in their Comprehensive Annual Financial Report (“CAFR”). Discretely presented component units are legally separate organizations for which the elected officials of the primary government (“Commonwealth”) are financially accountable. In addition, discretely presented component units can be other organizations of which the nature and significance of their relationship with the Commonwealth is such that exclusion of these organizations from the Commonwealth’s financial statements would be misleading.

We are a discretely presented component unit of the Commonwealth, because the Commonwealth appoints all twenty voting board members; a significant financial burden exists on the Commonwealth to subsidize the Pennsylvania State Grant Program; the Governor of Pennsylvania must approve our debt issuances; and although, the Commonwealth is not obligated for our debt, the Commonwealth has indicated it could take certain actions to satisfy debt holders.

Blended Component Units

PHEAA Student Loan Foundation, Inc.

We formed the PHEAA Student Loan Foundation, Inc. (“Foundation”) on August 6, 2002. The Foundation is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). Its charitable purpose is to carry out student loan securitization transactions for our benefit. The Foundation is a component unit, because we appoint a majority of the Foundation’s board of directors and we can impose our will on the Foundation. The Foundation is a blended component unit of PHEAA, because it provides services entirely to us. As a blended component unit, the financial results of the Foundation are consolidated with the financial results of PHEAA.

PHEAA Student Loan Trusts

We have various student loan trusts that are statutory trusts formed under the laws of the State of Delaware. The principal purposes of the student loan trusts are to securitize student loans and related assets and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the student loan trusts generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. See **Note 12 – Blended Component Units** for more details on the PHEAA Student Loan Trusts.

The Pennsylvania Higher Education Foundation, Inc.

We supported the formation of the Pennsylvania Higher Education Foundation, Inc. (“PHEF”), which is tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Its charitable purposes include, but are not limited to, activities intended to improve or enhance postsecondary education opportunities for students in Pennsylvania and elsewhere. PHEF is considered a component unit of PHEAA, because PHEAA appointed a voting majority of the PHEF’s governing board, and PHEAA has the ability to impose its will on PHEF. PHEF is considered a blended



component unit, because PHEF no longer provided services to outside third parties in the form of grants and scholarships used to promote nursing education, but rather provided services entirely to us. As a blended component unit, the financial results of PHEF are consolidated with the financial results of PHEAA.

On March 18, 2015, the Board of Directors authorized the dissolution of PHEF. As part of the dissolution of PHEF, all of the PHEF assets and all funds in its possession that have not been paid or set aside for PHEF's obligations are to be paid to the PHEAA, for its public purposes. On June 8, 2015, PHEF entered into an "Assignment of Rights Incident to Dissolution Agreement" with PHEAA. On October 29, 2015 the "Articles of Dissolution" were received by the PA Department of State Bureau of Corporations and Charitable Organizations, and PHEF was officially dissolved.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Accounting

The basic financial statements have been prepared in conformity with generally accepted accounting principles ("GAAP") in the United States applicable to governments. The Governmental Accounting Standards Board ("GASB") establishes accounting and financial reporting requirements for governments. We prepared our financial statements based on the governmental proprietary fund (enterprise fund) reporting concept, which follows the economic resources measurement focus and accrual basis of accounting. The proprietary fund financial reporting concept focuses on the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows.

Use of Estimates

The preparation of our financial statements in conformity with GAAP requires management to make estimates and assumptions that influence the reported assets, deferred outflow of resources, liabilities, deferred inflow of resources, net position, revenues, and expenses during the reporting periods. Actual results could differ significantly from those estimates.

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Cash equivalents include amounts in money market funds, federal agency discount notes, and commercial paper with original maturities at acquisition of three months or less. We report money market funds, commercial paper and federal agency discount notes at fair value.

Restricted Cash and Investments

Restricted cash and investments include cash received from financial institutions pending disbursement for student loans, cash received for the benefit of servicing customers, and cash and investments of bond proceeds held by a trustee and restricted by the provision of the bond indentures and financing agreements. We consider these amounts restricted and they cannot be disbursed for any other purpose.

Investments

Investments include amounts in the Commonwealth's Treasury Department Bureau of Cash Management and Investments ("Treasury Department") State Treasury Investment Pool ("STIP"), Pools 998 and 999, within the Commonwealth Investment Program ("CIP"). The CIP is an internal investment pool in which a number of Commonwealth agencies participate.

Pools 998 and 999 each has its own distinct investment strategies, goals, and holdings that reflect the differing needs of Commonwealth funds for income, cash flows, and risk tolerance. Pool 998 is a less liquid vehicle that allows for



investment in assets that offer potentially higher returns with commensurate risk. Pool 999 is a highly liquid vehicle that consists of short-term fixed income securities and cash, which provide a high degree of liquidity and security but only modest returns. The Treasury Department provides us information on the net asset value for Pools 998 and 999 and we report the amounts invested in these pools at fair value.

Student Loans Receivable, net

We report student loans in the Statements of Net Position at their unpaid principal balances net of an allowance for inherent losses within our student loan portfolio, and unamortized premiums and discounts on student loan purchased.

Allowance for loan losses

We estimated and established an allowance for loan losses based upon our continuing evaluation of our student loan portfolio, past and anticipated loss experience, current operating information, and changes in economic conditions. We maintain the allowances for loan losses at a level that is adequate to absorb estimated incurred losses, but our evaluation is inherently subjective and the required allowances may significantly change in the future.

FFEL Program Loans

The allowance for loan losses-FFEL program loans represents our estimate of the costs related to the risk sharing on FFEL program loans only. This allowance does not include the risk associated with non-FFEL program loans. We record a provision for loan losses on “FFEL program loans” as follows:

- FFEL program loans - The allowance for loan losses represents our estimate of the costs related to the risk sharing on the FFEL program loans and it is a weighted average calculation that considered the following guarantee rates:
 - 100% of the unpaid principal balance of each loan disbursed before October 1, 1993;
 - Not more than 98% of the unpaid principal balance of each loan disbursed on or after October 1, 1993 and before July 1, 2006; and
 - Not more than 97% of the unpaid principal balance of each loan disbursed on or after July 1, 2006 and before July 1, 2010. Student loans were no longer originated under the FFEL program on or after July 1, 2010.
- Cure loans – We consider a loan to be in “cure” status when a due diligence violation has occurred on a PHEAA owned loan and the servicer is attempting to correct or “cure” the loan. When a student loan enters a cure status, the guarantor will not guarantee the student loan and reimburse the lender for the outstanding principal and interest of the loan if the borrower defaults on the student loan while in a cure status. A loan can become incurable after three years of unsuccessfully trying to cure the loan, if a loan does not pay-off within the defined terms (i.e. 120 months for a 10 year Stafford loan), or due to an origination error. We record a provision for loan losses on any loans that have been in a cure status for greater than 24 months, and any loans considered incurable.

When a student loan defaults, the guarantor reimburses the lender based on the disbursement date of the student loan. We record a charge-off for the difference between the ending balance of the student loan and the guarantee rate.

Lastly, we write-off student loans that are non-performing. We send a “Final Demand Letter” to borrowers that have not submitted a payment within 36 months of default. Borrowers that have not remitted a payment within 45 days of receipt of the Final Demand Letter are processed for write-off.



Other Program Loans (Non-FFEL)

The allowance for loan losses-other program loans (Non-FFEL) represents our estimate of probable incurred losses associated with non-FFEL program loans, such as private and cure loans. We record a provision for loan losses on “other program loans” as follows:

- Private loans – We record a provision for loan losses on private loans when the student loan payment status is no longer current (payments are more than 120 days past due) and/or non-performing.
 - The student loans formerly guaranteed by The Education Resource Institute, Inc. (TERI) are included with the private loans. We record a provision on 100% of the TERI student loan balances that have a payment delinquency status of 121 days and greater, and those loans classified as “claims filed but not paid”.
 - The student loans associated with Pennsylvania nursing schools and the Health Education Assistance Loan (“HEAL”) supplemental student loans are included with the private loans. The Pennsylvania nursing school student loans are self-insured by us and the HEAL supplemental student loans are private student loans without a guarantee. We record a provision for loan losses for these programs when the student loans are greater than 120 days delinquent and student loans that have a claim filed or are non-performing.

We write-off student loans that are non-performing. We send a “Final Demand Letter” to borrowers that have not submitted a payment within 36 months of default. Borrowers that have not remitted a payment within 45 days of receipt of the Final Demand Letter are processed for write-off.

Lastly, we report expenses related to risk sharing on defaults in the provision for loan losses, and we include the expenses related to servicing deficiencies in “Other” operating expenses.

Capital Assets, net

We report capital assets at cost net of depreciation and estimated impairment, if any. We report assets held under capital leases at the present value of minimum lease payments net of amortization. We calculate depreciation based on the straight-line method over the estimated useful life of the asset. We amortize assets held under capital leases and leasehold improvements based on the straight-line method over the shorter of the lease term or the estimated useful life of the asset.

Software is made up of computer software and developed software. We capitalize computer software if the per unit costs, based on per license fee, is \$10,000 or more. We capitalize improvements or additions to existing software that constitute a capital outlay or increase the value or life of an existing asset by 25% or more of the original cost or life as a betterment and we record it as an addition to the value of the existing asset.

We capitalize software that is developed for internal use in our operations. The development of this software involves three phases: preliminary project phase, application development phase and post-implementation/operation phase. We expense the cost associated with the preliminary project and the post-implementation/operating phase. We capitalize internal and external costs associated with the application development phase. The capitalization of costs begins when the preliminary project phase is complete and management has implicitly authorized or commits to funding the software project with the intent it will be completed and used to perform its planned functions. Capitalization will cease no later than at the time when substantial testing is complete and the software is ready for its intended purpose or rendered into service. Upgrades and enhancements are modifications to existing internal-use software that result in additional functionality, that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require new software specifications and may require a change to all or part of the existing software specifications. We report software at cost net of amortization. We calculate amortization based on the straight-line method over the estimated useful life of the software.



We capitalize assets that cost \$10,000 or more; amounts under that threshold are expensed. The following estimated useful lives are used for significant asset categories:

- Buildings and improvements 7 – 40 years
- Furniture, furnishings and equipment 5 – 10 years
- Software (purchased and development) 4 – 5 years

Deferred Gain (Loss) on Bond Refundings

In a current refunding resulting in the defeasance of debt, the difference between the reacquisition price and the net carrying amount of the old debt is reported as a deferred outflow of resources (deferred loss on bond refundings) or a deferred inflow of resources (deferred gain on bond refundings) and recognized as a component of “Student loan financings” interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Compensated Absences

Employees earn annual leave based upon years of service and may carry forward up to 45 days of unused annual leave at the end of each calendar year. We pay employees for accumulated annual leave at termination or retirement. Employees earn sick leave and may carry forward up to 300 days of unused sick leave at the end of each calendar year. We pay employees a portion of accumulated sick leave at retirement based upon a formula. We include in accrued expenses on the Statements of Net Position the estimated amounts payable under these arrangements.

Revenue Recognition

Student loan interest revenue, net

We recognize student loan interest revenue as it is earned, net of consolidation rebate fees, government interest, special allowance interest, amortization of student loan purchase premiums and discounts, and write offs and recoveries.

We are required to pay the United States Department of Education (“ED”) a monthly Consolidation Loan Rebate Fee as a holder of Federal Consolidation loans. The Consolidation Loan Rebate Fee is equal to 0.0875% of the unpaid principal balance and the accrued interest on all Federal Consolidation Loans disbursed after October 1, 1993, and held by the lender on the last day of the month. This is equal to an annualized rate of 1.05%. Except for loans based on applications received during the period from October 1, 1998 and January 31, 1999, for which the rebate is equal to 0.05167% on a monthly basis or 0.62% on an annual basis. We record the payment of Consolidation Loan Rebate Fees as an adjustment to student loan interest revenue.

We earn interest subsidies and special allowance payments on certain FFEL program student loans within our student loan portfolio. ED makes interest subsidy payments to holders of qualifying FFEL program loans under the Higher Education Act of 1965, as amended, on subsidized Stafford loans and qualifying Consolidation loans, while the student is a qualified student, during a qualifying grace period and during periods of deferment. ED pays the interest subsidy payments based on the amount of interest accruing on the unpaid balance, prior to the commencement of repayment or during the deferment period. We record the interest subsidy payments as student loan interest revenue.

ED makes special allowance payments to holders of qualifying insured loans and guaranteed loans, subject to certain requirements under the Higher Education Act of 1965, as amended. ED makes the payments during any quarter in which the special allowance calculation is a positive number. For loans first disbursed between April 1, 2006 and June 30, 2010, ED will collect excess interest for quarters in which the interest rate on the loan exceeds the special allowance support level, commonly referred to as negative special allowance. We record the special allowance payments as student loan interest revenue.



The premium or discount on student loans purchases are calculated based on the difference between carrying value and the purchase price of the student loans at the time of purchase. The premium or discount of student loans is amortized over the estimated life of the student loan portfolio. We record the amortization of the student loan purchase premium or discount as student loan interest revenue.

Servicing fees

We earn servicing fee revenue by servicing student loans owned by third parties. We recognize servicing fees when we provide the contractual services and we record the unbilled amounts as accounts receivable.

Retention of Collections on Defaulted Loans, net

As a guarantor, we facilitate the guarantee of 97% - 100% of the borrower's outstanding loan balance depending on the disbursement date of the borrower's loan. The federal government reimburses the Federal Fund based upon default rates of the portfolio of guaranteed loans and the disbursement date of the loan. Retention of collections on defaulted loan rates are based upon the Higher Education Act, as amended.

After a loan defaults and the Federal Fund pays a claim, we continue to try to collect on the loan and we earn revenue on the collection of defaulted loans. For rehabilitated loan sales on and after July 1, 2014, we pay ED 100% of the principal balance of the loan at the time of sale (multiplied by the reinsurance percentage in effect when payment under the guaranty agreement was made with respect to the loan). In addition, we can retain collection costs and accrued interest. Collection costs charged to the borrower may not exceed 16% of the outstanding principal and interest at the time of the loan sale.

Lastly, in order to facilitate the sale of the rehabilitated student loans to eligible lenders, we purchase rehabilitated student loans and sell them to eligible lenders sometimes at a discount.

Federal Fees

We earn account maintenance fees, which we classify as federal fees, from operating the guaranty agency. ED pays us an annual account maintenance fee that is 0.06% of the original principal amount of outstanding loans guaranteed as long as the guarantee remains in force.

Operating Revenues and Expenses

Operating revenues include net interest revenue earned on student loans and investments and fees earned from providing services. Operating expenses include the costs of providing services and operating all programs. We do not report as a component of operating income the grants we receive and the grants and financial aid we disburse.

Commonwealth of Pennsylvania and Federal Grant Revenues

Commonwealth and federal grants are non-exchange transactions. We use the receipts as a source of funds to disburse grants and financial aid. Our agreements contain restrictions requiring us to spend the money in accordance with the legislation or grant agreement, but generally do not refer to specific time requirements. Accordingly, we recognize the entire amount as revenue when we receive it.

When an expense is incurred for the purposes of which both restricted and unrestricted net position are available, we first apply restricted resources and then unrestricted resources.

Elimination of Intra-Entity Activity

The PHEAA Student loan Trust I (the "Trust"), the PHEAA Student Loan Trust 2011-1 (the "2011-1 Trust"), the PHEAA Student Loan Trust 2012-1 (the "2012-1 Trust"), the PHEAA Student Loan Trust 2013-1 (the "2013-1 Trust"), the PHEAA Student Loan Trust 2013-2 (the "2013-2 Trust"), the PHEAA Student Loan Trust 2013-3 (the



“2013-3 Trust”), the PHEAA Student Loan Trust 2014-1 (the “2014-1 Trust”), the PHEAA Student Loan Trust 2014-2 (the “2014-2 Trust”), the PHEAA Student Loan Trust 2014-3 (the “2014-3 Trust”), the PHEAA Student Loan Trust 2015-1 (the “2015-1 Trust”), the PHEAA Student Loan Trust 2016-1 (the “2016-1 Trust”), the PHEAA Student Loan Trust 2016-2 (the “2016-2 Trust”) and the PHEAA Warehouse Facility Trust 2013-1 (the “Warehouse Trust 2013-1”) are blended component units of the Foundation, and the Foundation is a blended component unit of PHEAA. In addition, PHEF is a blended component unit of PHEAA. We consider the resource flows between PHEAA and the blended component units as intra-entity, because PHEAA is the administrator and servicer for the blended component units. We eliminate the intra-entity activity in the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows.

Note 3 – Recently Issued GASB Pronouncements

During 2015, the GASB issued Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (“GASB 75”). This Statement replaces the requirements of GASB Statements No. 45 - *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57 - *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans. The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. This Statement is effective for fiscal years beginning after June 15, 2017, and earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements.

During 2016, the GASB issued Statement No. 82 - *Pension Issues an amendment of GASB Statements No. 67, No. 68, and No. 73* (“GASB 82”). The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged. On July 1, 2016, we adopted and implemented GASB 82, and as of June 30, 2017, there was no material impact to the financial results of adopting and implementing GASB 82.

During 2016, the GASB issued Statement No. 83 – *Certain Asset Retirement Obligations* (“GASB 83”). This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements and we anticipate no changes to the financial results of adopting and implementing GASB 83.

During 2017, the GASB issued Statement No. 85 – *Omnibus 2017* (“GASB 85”). The objective of this Statement is to address practice issues that were identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB)). The requirements of this Statement are effective for reporting periods beginning after June 15, 2017.



Earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements and we do not anticipate any material changes to the financial results of adopting and implementing GASB 85.

Note 4 – Federal Student Loan Reserve Fund (Federal Fund) and Assets Held for the U.S. Department of Education

The following table shows the detail of the net position held by us for ED in the Federal Fund.

(Dollars in thousands)

As of June 30,	2017	2016
<u>Assets</u>		
Cash	\$ 6,621	38,301
Receivable from the U.S. Department of Education	55,548	36,935
Other receivables	826	219
Total assets	62,995	75,455
<u>Liabilities</u>		
Accounts payable and accrued expenses	2,338	1,997
Payable to the U.S. Department of Education	-	17,925
Amounts payable to PHEAA	205,935	228,032
Total liabilities	208,273	247,954
Net liabilities	\$ (145,278)	(172,499)

Under the Higher Education Act of 1965, as amended, (“HEA”) we are to act as a fiduciary in managing the assets of the Federal Fund. Under HEA, Section 428(c)(9)(A), we are required to maintain a current minimum reserve level of at least 0.25% of the total attributable amount of all outstanding loans guaranteed. Historically, ED has calculated this ratio at September 30, which is the close of the federal fiscal year, based upon regulatory reports that we file with ED.

As of June 30, 2017 and 2016, we reported \$60.7 million and \$55.5 million, respectively, in the line item “Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net” in the Statements of Net Position, which is the difference between the Federal Fund’s total assets, accounts payable and accrued expenses and amounts payable to USDE, excluding amounts payable to PHEAA.

Note 5 – Cash, Cash Equivalents and Investments

Overview

We manage our portfolio in such a manner that assures that funds are available as needed to meet the immediate and/or future operating requirements. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands. At maturity or liquidation, such monies shall be reinvested according to our investment guidelines and the prudent person rule.

Restricted cash and cash equivalents include amounts restricted under bond indentures and financing agreements, which are held by a trustee and managed under the provisions of the agreements. Restricted cash and cash equivalents also include amounts due to customers.

General Investment Objectives

The primary objectives, in priority order, of our investment activities are safety, liquidity, and yield.

Safety of principal is the foremost objective of our investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. Investment transactions must be designed to keep capital losses at a minimum, whether they are from securities defaults or erosion of market value. To further mitigate risk, our investment portfolio shall be diversified by the type of investment, issuer, and maturity date.

The liquidity of our portfolio shall be managed in such a manner that assures that funds are available as needed to meet the immediate and/or future operating requirements. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets. Also, a portion of the portfolio may be placed in money market mutual funds, which offer same-day liquidity for short-term funds.

The yield of the investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of the investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities will not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal;
- A security swap would improve the quality, yield, or target duration in the portfolio; and
- Liquidity needs of the portfolio require that the security be sold.

Standards of Care

The board of directors authorized the investments guidelines and we govern our investments by using the “prudent person” rule under our investment policy. Generally, our investments are limited to U.S. Government securities, U.S. Government agency securities, federal instrumentalities sponsored by U.S. agencies, high-grade commercial paper, repurchase agreements collateralized by U.S. Treasury obligations, certificates of deposit, bankers’ acceptances eligible for purchase by the Federal Reserve System, and other investments approved by the board of directors from time to time.

The standard of prudence used in our investment portfolio shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio. The prudent person rule requires the contractor to exercise: the judgment, care, skill, prudence and diligence under the circumstances then prevailing, which persons of prudence, discretion and intelligence, acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims by diversifying the investments of the funds, so as to minimize the risk, considering the probable income as well as the probable safety of their capital.

The following table shows the carrying value of cash and cash equivalents (unrestricted and restricted), investments (unrestricted and restricted), and cash on deposit.



(Dollars in thousands)

As of June 30,	2017	2016
Cash and cash equivalents	\$ 126,142	72,713
Restricted cash and cash equivalents	312,787	223,188
Restricted cash and cash equivalents – due to customers	84,592	72,256
Investments	544,638	531,706
Restricted investments	28,999	50,661
Carrying value	\$ 1,097,158	950,524

Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available; for others, it might not be available. However, the objective of a fair value measurement in both cases is the same—that is, to determine the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Fair value is an exit price at the measurement date from the perspective of a market participant that controls the asset or is obligated for the liability.

The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels. Level 1 inputs are quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for an asset or liability. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

The following table shows the fair value and the fair value measurements for our cash equivalents and investments.

(Dollars in thousands)

As of June 30, 2017	Cost Value	Fair Value	Level 1	Level 2	Level 3
<u>Cash equivalents</u>					
Money market funds:					
Federated money market funds	\$ 303,846	303,846	303,846	-	-
PFM Funds Prime Series – Institutional Shares	98,355	98,355	-	98,355	-
Federal agency discount notes	49,042	49,054	-	49,054	-
Commercial paper	39,430	39,475	-	39,475	-
Total cash equivalents	\$ 490,673	490,730	303,846	186,884	-
<u>Investments</u>					
State Treasury investment pool:					
Pool 998	\$ 145,797	145,797	-	-	145,797
Pool 999	427,840	427,840	-	-	427,840
Total investments	573,637	573,637	-	-	573,637
Total cash equivalents and investments	\$ 1,064,310	1,064,367	303,846	186,884	573,637



(Dollars in thousands)

As of June 30, 2016	Cost Value	Fair Value	Level 1	Level 2	Level 3
<u>Cash equivalents</u>					
Money market funds:					
Federated money market funds	\$ 214,961	214,961	214,961	-	-
PFM Funds Prime Series – Institutional Shares	64,576	64,576	-	64,576	-
Federal agency discount notes	61,719	61,721	-	61,721	-
Commercial paper	9,670	9,674	-	9,674	-
Total cash equivalents	\$ 350,926	350,932	214,961	135,971	-
<u>Investments</u>					
State Treasury investment pool:					
Pool 998	\$ 135,339	135,339	-	-	135,339
Pool 999	447,028	447,028	-	-	447,028
Total investments	582,367	582,367	-	-	582,367
Total cash equivalents and investments	\$ 933,293	933,299	214,961	135,971	582,367

Cash Equivalents

Money Market Funds

Federated Money Market Funds – As of June 30, 2017 and 2016, we held positions in various Federated money market funds and the fair values of those funds were \$303.8 million and \$215.0 million, respectively. The fair values of the Federated money market funds were valued using quoted market prices (Level 1).

PFM Funds Prime Series – As of June 30, 2017 and 2016, we held positions in PFM Funds Prime Series and the fair values were \$98.4 million and \$64.6 million, respectively. The fair values of the PFM Funds Prime Series were valued based on the published net asset value per share by PFM, which were not obtained from a quoted price in an active market (Level 2).

Federal Agency Discount Notes

As of June 30, 2017 and 2016, we held positions in federal agency discounted notes and the fair values were \$49.1 million and \$61.7 million, respectively. The fair values of the federal agency discount notes were based on a market approach using quoted prices by a third party for markets that are not active (Level 2).

Commercial Paper

As of June 30, 2017 and 2016, we held positions in commercial paper and the fair values were \$39.5 million and \$9.7 million, respectively. The fair values of the commercial paper were based on a market approach using quoted prices by a third party for markets that are not active (Level 2).

Investments

State Treasury Investment Pool

Investment Pools 998 and 999

The Commonwealth of Pennsylvania Treasury Department's Bureau of Cash Management and Investments maintain the State Treasury investment pool for the benefit of all Commonwealth funds, which is governed by the provisions of the State Treasury investment policy. The Treasury Department created two separate pools, Pools 998 and 999, within the Commonwealth Investment Program (CIP), each with its own distinctive investment strategies, goals, and holdings that reflect the differing needs of Commonwealth funds for income, cash flows, and investment risk tolerance. The CIP does not have any restrictive terms and conditions upon which a participant may redeem their investments in Pools 998 and 999.

Pool 998

Pool 998 operates much like a mutual fund: depending on market conditions, an account owner who makes a withdrawal may realize a gain or a loss. Shares in Pool 998 are priced at the most recent net asset value (NAV) per share, which fluctuates daily. Consequently, if a participant's average cost per share (based on its own history of purchases and redemptions) is less than the share price on the day of redemption, the participant will realize a capital gain in the shares redeemed. Conversely, if a participant's average cost per share exceeds the share price on the day of redemption, the participant will realize a capital loss on the shares redeemed. Pool 998 gains and losses are distributed periodically to participants in the form of reduced or increased share totals.

According to the Pennsylvania Treasury Annual Investment Report for the fiscal year ending June 30, 2016 (most recent annual report available), Pool 998's asset allocations were 56% invested in fixed income (including cash and cash equivalents) and 44% invested in equities and alternative assets. Pool 998 is benchmarked against a blended index of the Standard & Poor's 500 Index, the MCSI ACWI ex U.S. Index, the Barclay's Capital U.S. Aggregate Bond Index and the Merrill Lynch 6-Month U.S. Treasury Bill Index. For the equity portion of Pool 998's investments, a weighting of 75% is measured against the Standard & Poor's 500 Index and 25% is measured against the MCSI ACWI ex U.S. Index. For the fixed income portion of Pool 998's investments, a weighting of 83% is measured against the Barclay's Capital U.S. Aggregate Bond Index and 17% is measured against the Merrill Lynch 6-Month U.S. Treasury Bill Index.

As of June 30, 2017 and 2016, our investments in Pool 998 were \$145.8 million and \$135.3 million, respectively. The fair values of Pool 998 were based on unobservable inputs (Level 3), which primarily included our own data and market participant assumptions particular to PHEAA.

Pool 999

Pool 999 maintains a stable NAV of \$1 per share by investing exclusively in high quality fixed-income securities, primarily of short duration. Pool 999 is designed to generate income while minimizing investment volatility, which protects principal and ensures ready access to account balances through investments with easy liquidity. Pool 999's permitted investments include U.S. Treasury securities, federal agency securities, certificates of deposit, commercial paper, money market funds, repurchase agreements, and similar short-term fixed income instruments. According to the Pennsylvania Treasury Annual Investment Report for the fiscal year ending June 30, 2016 (most recent annual report available), Pool 999's asset allocations were 100% invested in fixed income (including cash and cash equivalents).

The value of a share in Pool 999 is calculated daily, incorporating all realized and unrealized gains and losses, and any cash returned from investments. All gains and losses are distributed to participants monthly to re-set the value to \$1 per share. Pool 999's performance is benchmarked against the Merrill Lynch 3-Month U.S. Treasury Bill Index. As of June 30, 2017 and 2016, our investments in Pool 999 were \$427.8 million and \$447.0 million, respectively.



The fair values for Pools 999 were based on unobservable inputs (Level 3), which primarily included our own data and market participant assumptions particular to PHEAA.

As of and for the period ended June 30, 2017, there were no transfers between the fair value hierarchy levels for the previously mentioned cash equivalents and investments.

For more information on Pools 998 and 999, see the Pennsylvania Treasury “Annual Investment Report for Fiscal Year Ended June 30, 2016”, which can be found at www.patreasury.gov/reports/investments.html.

Deposits and investments have certain risks that have the potential to result in losses, and those risks are described in the following sections.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. We manage our exposure to interest rate risk by structuring our investment portfolio so that investments mature to meet cash requirements for ongoing operations and investing operating funds primarily in shorter-term investments.

As of June 30, 2017 and 2016, \$490.7 million and \$350.9 million, respectively, of our cash equivalents have maturities of less than one year. As of June 30, 2017 and 2016, \$573.6 million and \$582.4 million, respectively, of our investments in the State Treasury Investment Pool have maturities of less than one year.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. We minimize our credit risk by limiting investments to authorized investments that have a higher credit rating and diversifying the investment portfolio so potential losses on individual investments will be minimized. This risk is measured by the assignment of a rating by a nationally recognized statistical rating organization.

As of June 30, 2017, all of our investments in commercial paper were rated A-1. As of June 30, 2017, all of our investments in money market funds were rated AAAM. As of June 30, 2017, \$573.6 million was invested in the State Treasury investment pool, and the investment pool was not rated.

As of June 30, 2016, all of our investments in commercial paper were rated A-1 and higher. As of June 30, 2016, all of our investments in money market funds were rated AAAM. As of June 30, 2016, \$582.4 million was invested in the State Treasury investment pool, and the investment pool was not rated.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, we would not be able to recover deposits or collateral securities that are in the possession of an outside party.

As of June 30, 2017, we had \$15.8 million of cash deposits with financial institutions of which \$15.5 million was in excess of the federal depository insurance limits.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of our investment in a single issuer. Our investment policy does not contain requirements that limit the amount that can be invested in any one issuer.

As of June 30, 2017, our investment in federal agency discount notes (FHLB) were less than 5% of our total cash equivalents and investments. As of June 30, 2016, our investment in FHLB represented 6.6% of our total cash equivalents and investments.



Note 6 – Student Loans Receivable, net

The following table shows our student loan holdings.

(Dollars in thousands)

As of June 30,	2017	2016
FFEL:		
Consolidation	\$ 4,057,477	4,705,793
Stafford	849,572	1,074,457
PLUS	75,457	104,978
Supplemental Loans for Students (SLS)	812	987
Total FFEL student loans	4,983,318	5,886,215
Private and HEAL student loans:		
Private	20,133	28,789
HEAL	19,103	27,974
Total private and HEAL student loans	39,236	56,763
Total student loans receivable	5,022,554	5,942,978
Unamortized premium on student loan purchases	5,559	8,203
Unamortized discount on student loan purchases	(8,308)	(11,913)
Allowance for loan losses	(6,646)	(21,229)
Total student loans receivable, net	\$ 5,013,159	5,918,039

Allowance for loan losses

In the table that follows, we report the “provision for losses – FFEL program loans” and the “provision for losses - other program loans (Non-FFEL)” as the “provision for loan losses” in the Statements of Revenues, Expenses and Changes in Net Position.

We present an analysis of our allowance for loan losses related to student loans in the following table.

(Dollars in thousands)

As of June 30,	2017	2016
Balance at beginning of period	\$ 21,229	20,871
Provision for losses – FFEL program loans	3,228	7,882
Provision for losses – other program loans (Non-FFEL)	667	(1,141)
Charge-offs/Write-offs	(18,478)	(6,383)
Balance at end of period	\$ 6,646	21,229

Note 7 – Capital Assets, net

The following tables show an analysis of the capital asset activity.

(Dollars in thousands)

As of and for the year ended June 30, 2017	Beginning Balance	Additions	Retirements	Ending Balance
Land	\$ 8,038	-	-	8,038
Buildings and improvements	75,476	650	(59)	76,067
Software	43,690	18,706	(4,086)	58,310
Information technology equipment	17,850	5,981	(420)	23,411
Other equipment	17,499	1,087	(122)	18,464
Total capital assets	162,553	26,424	(4,687)	184,290
Less accumulated depreciation and amortization for:				
Buildings and improvements	(42,394)	(2,048)	39	(44,403)
Software	(22,663)	(8,949)	3,628	(27,984)
Information technology equipment	(8,026)	(3,749)	382	(11,393)
Other equipment	(10,383)	(2,012)	123	(12,272)
Total accumulated depreciation and amortization	(83,466)	(16,758)	4,172	(96,052)
Total capital assets, net	\$ 79,087	9,666	(515)	88,238

(Dollars in thousands)

As of and for the year ended June 30, 2016	Beginning Balance	Additions	Retirements	Ending Balance
Land	\$ 8,038	-	-	8,038
Buildings and improvements	73,762	1,714	-	75,476
Software	37,538	10,015	(3,863)	43,690
Information technology equipment	17,323	3,991	(3,464)	17,850
Other equipment	16,913	1,415	(829)	17,499
Total capital assets	153,574	17,135	(8,156)	162,553
Less accumulated depreciation and amortization for:				
Buildings and improvements	(40,391)	(2,003)	-	(42,394)
Software	(19,427)	(7,098)	3,862	(22,663)
Information technology equipment	(8,660)	(2,606)	3,240	(8,026)
Other equipment	(9,137)	(2,063)	817	(10,383)
Total accumulated depreciation and amortization	(77,615)	(13,770)	7,919	(83,466)
Total capital assets, net	\$ 75,959	3,365	(237)	79,087

Depreciation expense for the years ended June 30, 2017 and 2016 was \$16.8 million and \$13.8 million, respectively.



Note 8 – Notes and Bonds Payable and Other Financings

The following table shows the activity of our student loan and other financings.

(Dollars in thousands)					Amounts Due within One Year
As of and for the year ended June 30, 2017	Beginning Balance	Increases	Decreases	Ending Balance	
Student loan financings:					
Student loan floating rate notes, due 2028 - 2065, at weighted-average rates of 1.95% as of June 30, 2017 and 1.17% as of June 30, 2016.	\$ 4,545,443	928,223	(873,723)	4,599,943	-
Deferred gain on bond refunding of student loan floating rate notes.	134,067	-	(51,820)	82,247	-
Deferred loss on bond refunding of student loan floating rate notes.	(1,299)	-	458	(841)	-
Discount on student loan floating rate notes.	(11,802)	(2,655)	4,161	(10,296)	-
Student loan auction rate security bonds, due 2042 - 2044, at weighted-average rates of 2.29% as of June 30, 2017 and 1.65% as of June 30, 2016.	218,200	-	(45,050)	173,150	-
Student loan financing warehouse facilities.	738,213	-	(738,213)	-	-
Student loan financings, due on demand, at weighted-average rates of 1.73% as of June 30, 2017 and 1.20% as of June 30, 2016.	200,000	-	-	200,000	200,000
Total student loan financings	\$ 5,822,822	925,568	(1,704,187)	5,044,203	200,000
Other financings:					
Capital acquisition refunding bonds, Series of 2012, due 2017 – 2022, at weighted- average rates of 4.15% as of June 30, 2017 and 2016.	\$ 26,195	-	(3,895)	22,300	4,055
Unamortized premium on capital acquisition refunding bonds.	2,154	-	(580)	1,574	-
Term financings, due 2029, at zero percent interest as of June 30, 2017 and 2016.	6,280	-	-	6,280	-
Total other financings	34,629	-	(4,475)	30,154	4,055
Total student loan and other financings	\$ 5,857,451	925,568	(1,708,662)	5,074,357	204,055

The note and bond indentures, among other things, require us to comply with various covenants, such as parity ratio requirements and annual financial statement, servicing and administration audits. Student loans and investments



collateralize all student loan financings. As of June 30, 2017, \$5.1 billion of student loan principal and related interest receivable and \$309.0 million of cash equivalents collateralized the \$5.0 billion of student loan financings.

As of June 30, 2017, the student loan financings and other financings are non-recourse obligations to our unrestricted net position and to the Commonwealth, except for the \$200.0 million of student loan financings and \$22.3 million of Capital Acquisition Refunding Bonds, Series of 2012, which are recourse obligations to us.

Student loan financings

For the year ended June 30, 2017, the student loan financings increased \$925.6 million due to the PHEAA Student Loan Trust 2016-1 ("2016-1 Trust") bond refunding on September 14, 2016 and the PHEAA Student Loan Trust 2016-2 ("2016-2 Trust") bond refunding on November 22, 2016.

On September 14, 2016, the 2016-1 Trust issued \$534.0 million of original principal amount of student loan asset backed notes, Class A ("Class A Notes"), at par, and \$11.6 million of original principal amount of student loan asset backed notes, Class B ("Class B Notes"), at a discount. The Class A Notes were issued with an interest rate of 1-month LIBOR plus 1.15% and a final maturity of September 25, 2065. The Class B Notes had a price to public of 84.00%, which resulted in a discount of \$1.9 million. The Class B Notes were issued with an interest rate of 1-month LIBOR plus 1.50% and a final maturity date of September 25, 2065.

On November 22, 2016, the 2016-2 Trust issued \$375.7 million of original principal amount of student loan asset backed notes, Class A ("Class A Notes"), at par, and \$7.0 million of original principal amount of student loan asset backed notes, Class B ("Class B Notes"), at a discount. The Class A Notes were issued with an interest rate of 1-month LIBOR plus 0.95% and a final maturity of November 25, 2065. The Class B Notes had a price to public of 88.52%, which resulted in a discount of \$803 thousand. The Class B Notes were issued with an interest rate of 1-month LIBOR plus 1.50% and a final maturity date of November 25, 2065.

For the year ended June 30, 2017, the student loan financings decreased \$1.7 billion due to required debt payments, scheduled amortization of deferred gains and losses on bond refundings and scheduled amortization of discounts on student loan floating rate notes. In addition, as part of the bond refundings that took place on September 14, 2016 and November 22, 2016, \$688.2 million of the bond proceeds were used to pay down the student loan financing warehouse facilities.

Other financings

For the year ended June 30, 2017, the other financings decreased \$4.5 million due to required debt payments and scheduled amortization of premium on capital acquisition refunding bonds.

Debt service requirements

The table that follows displays the debt service requirements based on estimated interest rates for the variable rate debt and the stated maturities for the student loan and other financings.



(Dollars in thousands) Fiscal Year of Maturity	Student Loan Financings		Other Financings	
	Principal	Interest	Principal	Interest
2018	\$ 200,000	93,985	\$ 4,055	833
2019	-	93,701	4,230	661
2020	-	93,701	4,415	482
2021	-	93,701	4,595	295
2022	-	93,701	4,795	100
2023-2027	-	468,505	210	4
2028-2032	230,266	455,551	6,280	-
2033-2037	810,955	437,468	-	-
2038-2042	1,821,202	300,947	-	-
2043-2047	910,950	127,034	-	-
2048-2052	-	109,330	-	-
2053-2057	200,284	108,971	-	-
2058-2062	-	91,644	-	-
2063-2067	799,436	60,516	-	-
	\$ 4,973,093	2,628,755	\$ 28,580	2,375

The student loan financings are variable-rate debt, which have interest rates that reset on various dates. As of June 30, 2017, interest rates on \$173.2 million reset based upon auctions every 28 days, and \$4.8 billion was indexed to the 1-month or 3-month LIBOR.

Note 9 – Retirement and Other Postemployment Benefits

Retirement Plan

Plan Description

We contribute to the Commonwealth of Pennsylvania State Employees' Retirement System ("SERS"), which the Commonwealth established under the provisions of Public Law 858, No. 331. SERS is the administrator of a cost-sharing multiple-employer defined benefit retirement plan to provide pension benefits for employees of state government and certain independent agencies.

SERS is a component unit of the Commonwealth and is included in the Commonwealth's comprehensive annual financial report ("CAFR") as a pension trust fund. As a pension trust fund, SERS issues a CAFR that includes financial statements and required supplementary information. The SERS CAFR is available on-line at www.sers.state.pa.gov, select "Newsroom", select "SERS Facts" and the CAFRs are listed by year under the section titled "Comprehensive Annual Financial Reports". Written requests for the SERS CAFR should be directed to the following address: State Employees' Retirement System, 30 North Third Street, Suite 150, Harrisburg, Pennsylvania 17101-1716.

Summary of Significant Accounting Policies

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of SERS and additions to/deductions from SERS fiduciary net position have been determined on the same basis as they are reported by SERS.

Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has a legal requirement to provide the contributions. Investment purchases and sales are recorded on a trade-date basis, and reported at fair value.

Retirement Benefits

Article II of the Commonwealth of Pennsylvania's Constitution assigns the authority to establish and amend the benefit provision of the plan to the General Assembly. On November 23, 2010, the Governor signed H.B. 2497 into law as PA Act 120. This legislation preserved the benefits in place for all members prior to January 1, 2011, but mandated a number of benefit reductions for members that join SERS on or after January 1, 2011. Below is a listing of some of the benefit reductions that are included in PA Act 120:

- Created A-3 and A-4 Class of Service - Class A-3 members will contribute 6.25% of their pay toward their benefit, and they will accrue benefits at 2.0% of their final average salary for each year of credited service. Class A-4 members will contribute 9.3% of their pay toward their benefit, and they will accrue benefits at 2.5% of their final average salary for each year of credited service;
- Increases the vesting period for Class A-3 and A-4 members to 10 years;
- Increases normal retirement age for Class A-3 and A-4 members from 60 to 65;
- Gradually increases funding through the use of collars that cap employer contribution rate increases;
- Implements a shared risk provision that introduces the possibility of higher or lower member contribution rates for future members; and
- Re-amortizes the SERS existing liabilities over 30 years through an actuarial "Fresh Start".

Prior to PA Act 120, employees who retire at age 60 with three years of service or with 35 years of service if under age 60, are entitled to a normal annual retirement benefit. Most members of SERS, and all state employees hired after June 30, 2001 and prior to January 1, 2011, are Class AA members. The multiplier for Class AA is 1.25, which translates into an annual benefit of 2.5% of the member's highest three-year average salary times years of service. Most members vest with five years of credited service.

Funding Policy

The State Employees Retirement Code (SERC), section 5507, requires the Commonwealth and other employers whose employees are SERS members to make contributions to the fund on behalf of all active members and annuitants necessary to fund the liabilities and provide the annuity reserves required to pay benefits. The SERS board of directors certifies the employer contribution rates on an annual basis, typically in April of each year to become effective the following fiscal year beginning in July. The employer rates are determined based on an independent actuarial valuation of the pension fund. The actuarial valuation assesses the pension system's current funds and determines its future expected liabilities. The employer contribution rate is set so that it can fund all retirement benefits earned by employees working during the year and pay toward any unfunded liability that may exist. In some cases, the actuarially calculated employer contribution rate has been set or adjusted by Pennsylvania law. Lastly, according to the SERC, all obligations of SERS will be assumed by the Commonwealth should SERS terminate.

PA Act 120 gradually increases funding with collars (limits) that cap employer contribution rate increases. The collar for the Commonwealth's fiscal year 2015-16 was 4.5% and will no longer apply effective July 1, 2017.

For the year ended June 30, 2017, the employer contribution rate was 23.96% for the "A" Class of Service employees, 29.95% for the "AA" Class of Service employees and 20.70% for the "A-3" and "A-4" Class of Service employees. For the year ended June 30, 2016, the employer contribution rate was 19.89% for the "A" Class of Service employees, 24.86% for the "AA" Class of Service employees and 17.18% for the "A-3" and "A-4" Class of Service employees. On July 1, 2017, the employer contribution rates will be 27.55% for the "A" Class of Service employees, 34.44% for the "AA" Class of Service employees and 23.80% for the "A-3" and "A-4" Class of Service employees.



According to the Commonwealth of Pennsylvania SERS 2016 actuarial report, Schedule K, page 2 (Projection of Expected Contributions and Benefits), the actual projected employer rate for fiscal year 2017-18 will be 32.8% and remain above 28% through fiscal year 2027.

For the years ended June 30, 2017, 2016 and 2015, our statutorily required contributions were \$42.0 million, \$36.1 million and \$26.7 million, respectively, and these contributions were equal to the required contributions set by SERS.

SERS GASB 68 Valuation

SERS released the “GASB 68 Valuation”, which had a valuation date of December 31, 2016 (**measurement date**), to the cost-sharing employers of the multiple-employer defined benefit retirement plan. It should be noted that the SERS valuation measurement date of December 31, 2016 is **not** the same as PHEAA’s fiscal year end date of June 30, 2017.

The information that follows on “Assumptions and Other Inputs” and the “GASB 68 Employer Schedules” were provided by SERS in the GASB 68 Valuation mentioned above. In some cases, SERS provided us with total plan-level information in which we applied our proportionate share percentage in to order to calculate the required schedules under GASB 68. As stated previously in the “Plan Description”, separately issued financial statements for SERS can be obtained from SERS management at www.sers.state.pa.gov.

Proportionate Share of Net Pension Liability

As of June 30, 2017, our proportionate share of net pension liability was \$474.7 million. The net pension liability was measured as of December 31, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. As of June 30, 2016, our proportionate share of net pension liability was \$440.7 million, which the net pension liability was measured as of December 31, 2015.

The following tables present our proportionate share of net pension liability as of June 30, 2017 and 2016. As stated previously, PHEAA’s proportionate share percentage was rounded to the nearest hundredth of a percent; therefore, you will not be able to recalculate “PHEAA’s proportionate share of net pension liability”.

(Dollars in thousands)

As of June 30,	2017	2016
SERS net pension liability	\$ 19,260,326	\$ 18,183,831
PHEAA’s allocation percentage	2.46%	2.42%
PHEAA’s proportionate share of net pension liability	\$ 474,743	\$ 440,673

PHEAA’s Allocation Percentage Methodology

The allocation percentage assigned to PHEAA was based on a projected-contribution method. This methodology applies the most recently calculated contribution rates for the Commonwealth’s 2017-2018 fiscal year, from the December 31, 2016 funding valuation, to the expected funding payroll for the allocation of the calendar year 2016 amounts.

The amounts assigned to us were our proportionate share of the net pension liability, pension expense, deferred outflows of resources and deferred inflows of resources (the collective pension amounts) determined in accordance with GASB 68.



As of June 30, 2017, our allocation percentage was 2.46%, a 1.7% increase from our allocation percentage of 2.42% as of June 30, 2016. The allocation percentages were measured as of December 31, 2016 and 2015, respectively.

In the tables below, we present our proportionate share allocation percentages, which were rounded to the nearest hundredth of a percent.

(Dollars in thousands)

As of June 30, 2017

Projected contributions, July 1, 2017 through June 30, 2018	\$	50,665
Total projected contributions, July 1, 2017 through June 30, 2018	\$	2,055,496
PHEAA's allocation percentage (rounded to the nearest hundredth)		2.46%

(Dollars in thousands)

As of June 30, 2016

Projected contributions, July 1, 2016 through June 30, 2017	\$	44,675
Total projected contributions, July 1, 2016 through June 30, 2017	\$	1,843,462
PHEAA's allocation percentage (rounded to the nearest hundredth)		2.42%

Assumptions and Other Inputs

Actuarial Methods and Assumptions

The GASB 68 Valuation states that every five years SERS is required to conduct an actuarial experience study to determine whether the assumptions used in its annual actuarial valuations remain accurate based on current and anticipated demographic trends and economic conditions. The *18th Investigation of Actuarial Experience* study for the period 2011 – 2015 was released in March 2016. The actuary, under oversight of the SERS Board, reviewed economic assumptions (such as the assumed future investment returns and salary increases) as well as demographic assumptions (such as employee turnover, retirement, disability, and death rates). Some assumption adjustments increased projected cost and some decreased projected cost, but the overall result was a slight increase to the net pension liability in 2015 upon adoption.

The SERS board adopted the actuarial assumptions set forth in the *18th Investigation of Actuarial Experience* at its March 2016 meeting. The study can be viewed at www.SERS.pa.gov.

In addition to the five-year experience study, SERS review its investment return assumption in light of economic conditions every year as part of its annual valuation. Based on this work, SERS actuary recommended and the SERS board adopted at the April 2017 meeting, a reduction in the targeted investment return rate assumption to 7.25% for the 2016 actuarial valuation from 7.5% used for the 2015 actuarial valuation based on the experience study. In addition, SERS actuary recommended, and the SERS board adopted, a reduction in the inflation rate of 2.6% for the 2016 valuation from 2.75% used for the 2015 actuarial valuation based on the experience study. The change in inflation rate also impacted the general salary growth, which was lowered to 2.9% for the 2016 valuation from 3.05% for the 2015 valuation based on the experience study.



The following methods and assumptions were used in the GASB 68 Valuation for the December 31, 2016 measurement date:

- Actuarial cost method – entry age
- Amortization method – straight-line amortization of investments over five years and amortization of assumption changes and noninvestment gains/losses over the average expected remaining service lives of all employees that provided benefits
- Investment rate of return – 7.25% net of expenses including inflation
- Projected salary increases – average of 5.60% with a range of 3.70% to 8.90% including inflation.
- Asset valuation method – fair market value
- Inflation – 2.60%
- Mortality rate – projected RP-2000 Mortality Tables adjusted for actual plan experience and future improvement
- Cost of living adjustment (COLA) – ad hoc

The long-term expected real rate of return on pension plan investments is determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of manager fees and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in SERS current and target asset allocation in the following table:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
Private Equity	16.00%	8.00%
Global Public Equity	43.00%	5.30%
Real Estate	12.00%	5.44%
Hedge Funds	12.00%	4.75%
Fixed Income	14.00%	1.63%
Cash	3.00%	(0.25)%
Total	100.00%	

The information presented in the table above was based on a 7.5% assumed investment rate of return, which was in place during calendar year 2016. Targets and/or expected returns may be updated to reflect the new assumed investment rate of return in the upcoming calendar year.

Discount Rate

According to the GASB 68 Valuation, the discount rate used to measure the total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the rates applicable for each member and that employer contributions will be made based on rates determined by the actuary and as set by statute. Based on those assumptions, SERS fiduciary net position was projected to be available to make all projected future benefit payments of current active and non-active SERS members. Therefore, the long-term expected rate of return on SERS investments was applied to all periods of projected benefit payments to determine the total pension liability.



Sensitivity of PHEAA's Proportionate Share of Net Pension Liability to Changes in the Discount Rate

The following table presents our proportionate share of the net pension liability calculated using the discount rate of 7.25% as of June 30, 2017 and 7.50% as of June 30, 2016, as well as the impact on the net pension liability if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate. As mentioned in the previous section titled "Actuarial Methods and Assumptions", SERS reduced the discount rate from 7.50% for the December 31, 2015 valuation to 7.25% for the December 31, 2016 valuation.

(Dollars in thousands)	1% decrease in the discount rate	Discount rate	1% increase in the discount rate
June 30, 2017 - Discount rate - 7.25%	\$587,517	\$474,743	\$378,169
June 30, 2016 - Discount rate - 7.50%	\$547,399	\$440,673	\$349,162

GASB 68 Employer Schedules

Proportionate Share of Total Deferred Outflows of Resources and Total Inflows of Resources

As of June 30, 2017, our deferred outflows of resources and deferred inflows of resources related to pensions were \$134.0 million and \$11.6 million, respectively. As of June 30, 2016, our deferred outflows of resources and deferred inflows of resources related to pensions were \$126.8 million and \$872 thousand, respectively.

The following tables present the components of our proportionate share of total deferred outflows of resources and total inflows of resources related to pensions.

(Dollars in thousands)

Deferred Outflows of Resources

As of June 30,	Differences between expected and actual experience	Net difference between projected and actual investment earnings on pension plan investments	Changes in assumptions	Changes in proportion	Contributions subsequent to the measurement date	Total Deferred Outflow of Resources
2017	\$6,853	39,897	28,998	35,291	22,930	\$133,969
2016	\$8,923	44,868	13,092	40,165	19,778	\$126,826

(Dollars in thousands)

Deferred Inflows of Resources

As of June 30,	Differences between expected and actual experience	Differences between employer contributions and proportionate share of contributions	Total Deferred Inflow of Resources
2017	\$10,622	\$979	\$11,601
2016	-	\$872	\$872

Amortization of Deferred Outflows of Resources and Deferred Inflows of Resources

The components of deferred outflows of resources and deferred inflows of resources, other than the net difference between the projected and actual investment earnings on SERS pension plan investments, are amortized into pension



expense over 5.2 years. The net difference between the projected and actual investment earnings on SERS pension plan investments are amortized in pension expense over 5.0 years.

The amounts of deferred outflows of resources and deferred inflows of resources related to the items previously reported as of June 30, 2017, which will be recognized in pension expense in future periods are as follows:

(Dollars in thousands)

For the year ended June 30,	2018	2019	2020	2021	2022	Thereafter
Deferred outflows of resources	\$ 57,731	34,801	30,657	9,637	1,143	-
Deferred inflows of resources	2,853	2,853	2,760	2,613	522	-
Net amortization	\$ 54,878	31,948	27,897	7,024	621	-

Pension Expense

For the year ended June 30, 2017 and 2016, our proportionate share of total pension expense was \$79.7 million and \$68.0 million, respectively. The components of our proportionate share of total pension expense are as follows:

(Dollars in thousands)

For the year ended June 30,	PHEAA's proportionate share of allocable plan pension expense	Net amortization of the difference between PHEAA's contributions and proportionate share of contributions	Net amortization of deferred amounts from changes in proportion	Total pension expense excluding that attributable to employer-paid member contributions
2017	\$68,709	(324)	11,266	\$79,651
2016	\$58,213	(241)	10,037	\$68,009

Other Postemployment Benefits

Plan Description

The Commonwealth of Pennsylvania (Commonwealth) sponsors the Retired Employees' Health Program (REHP). We participate in the Commonwealth's REHP, a single-employer defined benefit postemployment healthcare plan administered by the Pennsylvania Employees' Benefit Trust Fund (PEBTF), acting as a third-party administrator on behalf of the Commonwealth's Office of Administration. The REHP provides health care and prescription drug plan benefits to eligible Commonwealth retirees, and their eligible dependents. The REHP's benefit provisions are established and may be amended by the Commonwealth of Pennsylvania's Office of Administration.

While the Commonwealth accounts for the REHP as a single employer plan, we account for our participation in the plan as a cost-sharing employer, because the plan is administered like a cost-sharing plan with a single actuarial valuation and the Commonwealth allocates annual OPEB costs to Commonwealth funds and component units, consistent with a pooling arrangement. Additionally, the Commonwealth structured the REHP so that employer contributions are irrevocable, plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan, and plan assets are legally protected from creditors of the employer(s) or plan administrator.

The REHP does not issue stand-alone financial statements, however the REHP note disclosures will be included in the Commonwealth's CAFR for the year ended June 30, 2017. For additional information on the REHP including the Commonwealth's total Other Post Employment Benefit (OPEB) expenses, funded status, funding progress, actuarial accrued liability, and the actuarial assumptions used to determine these amounts for the Commonwealth's REHP, the most recent actuarial report is available for review at www.budget.state.pa.us (select Publications &

Reports and select “Actuarial Valuation of the Commonwealth’s Other Post-Employment Benefits: REHP (August 2015)).

Funding Policy

The Office of Administration and the Governor’s Budget Office establish REHP contribution requirements. All employing agencies and certain plan members of the Commonwealth must contribute specified amounts to the REHP.

REHP plan members with a retirement date between July 1, 2005 and June 30, 2007, must contribute 1.0% of their final annual gross salary toward the cost of REHP coverage. REHP plan members with a retirement date on or after July 1, 2007, must contribute a percentage of their final annual gross salary toward the cost of REHP coverage. The contribution rate shall be equal to the active employee contribution rate in effect at the date of retirement, which is a percentage of the employee’s final annual gross salary. The contribution rate shall change thereafter in accordance with the active employee contribution.

For the years ended June 30, 2017, 2016 and 2015, our annual contribution rate was \$4.7 million, \$4.7 million and \$4.0 million, respectively, and we have made all required contributions to the REHP as determined by the Office of Administration.

The monthly contribution rate was based on a projected per retiree cost for the related fiscal years times the estimated number of PHEAA retirees enrolled in the REHP. Effective July 1, 2017, our contribution rate will be \$380 thousand per month or \$4.6 million annually. This current level of funding generally represents an amount needed to fund ongoing annuitant health care costs for the current year with a smaller portion representing advance funding.

The Statements of Funded Status and Funding Progress are disclosed in the Commonwealth’s CAFR, Note I – Pension and Other Postretirement Benefits for the fiscal year ended June 30, 2016. The June 30, 2016 Commonwealth’s CAFR can be accessed on-line at www.budget.state.pa.us, select “Publications & Reports” and select “Annual Financial Reports”.

Note 10 – Servicing Fees

As a servicer, we are responsible for servicing, maintaining custody of, and making collections on student loans. We earn servicing fee revenue by servicing student loans owned by third parties. We categorize revenue earned from loans owned by financial institutions and secondary markets as “Commercial Servicing”; whereas, we categorize revenue earned from loans owned by ED as “FLS Servicing”. We categorize revenue earned from providing our system to guarantors and other servicers to use, as well as, not-for-profit servicers who were awarded servicing contracts by ED, as “Remote Servicing”.

For the years ended June 30, 2017 and 2016, total servicing revenues were \$321.4 million and \$324.7 million, respectively. For the years ended June 30, 2017 and 2016, we were servicing on average \$320.3 billion and \$289.5 billion, respectively, of loans for third party customers. For the years ended June 30, 2017 and 2016, customers using our servicing systems serviced on average \$52.3 billion and \$46.5 billion, respectively, of loans.

Our servicing agreements, some of which expired during the fiscal year ended June 30, 2017, have contractual terms at inception ranging from three years to life of loan. Under our servicing agreements, we generally agree to reimburse customers for any claims, losses, liabilities, or expenses that arise out of or relate to our acts or omissions with respect to services provided under such agreements. We record a provision for estimated claims under the agreements as “other” operating expenses in the financial statements.

For the year ended June 30, 2017, ED provided \$194.9 million of servicing revenue, which represents 60.6% of the total servicing revenue. The next three loan-servicing customers provided \$48.4 million of servicing revenue, which represents 15.1% of the total servicing revenue.



For the year ended June 30, 2016, ED provided \$188.5 million of servicing revenue, which represents 58.1% of the total servicing revenue. The next three loan-servicing customers provided \$51.7 million of servicing revenue, which represents 15.9% of the total servicing revenue.

Note 11 – Segment Information

Our Student Loan segment generally finances student loan portfolios by issuing notes, bonds, and other financings and we pledge the earnings to support the debt. Because we pledge the revenue stream of the student loan portfolios to support the debt, we are reporting condensed financial information about the Student Loan segment. The notes, bonds, and other financings related to this segment are limited obligations payable only from the pledged assets.

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the years ended June 30,	2017	2016
Interest revenue	\$ 143,689	148,091
Interest expense	(37,781)	(37,324)
Net interest revenue	105,908	110,767
Provision for loan losses	(2,536)	(7,045)
Net interest revenue after provision for loan losses	103,372	103,722
Total noninterest revenue	314	919
Total operating revenues	103,686	104,641
Operating expenses	(39,456)	(40,487)
Operating income	64,230	64,154
Transfers to unrestricted net position	(68,774)	(17,211)
Changes in net position	(4,544)	46,943
Net position, beginning of period	310,324	263,381
Net position, end of period	\$ 305,780	310,324



Statements of Net Position

(Dollars in thousands)

As of June 30,	2017	2016
Current assets:		
Restricted cash and cash equivalents	\$ 308,989	218,582
Student loans receivable	840,652	947,881
Interest income receivable	71,554	72,787
Other assets	6	8
Total current assets	1,221,201	1,239,258
Long-term assets:		
Student loans receivable, net	4,148,573	4,914,498
Total long-term assets	4,148,573	4,914,498
Total assets	5,369,774	6,153,756
Deferred outflow of resources:		
Deferred loss on bond refundings	841	1,299
Total deferred outflow of resources	841	1,299
Current liabilities:		
Accounts payable and accrued expenses	19,791	20,610
Student loan financings	200,000	938,213
Total current liabilities	219,791	958,823
Long-term liabilities:		
Student loan financings, net	4,762,797	4,751,841
Total long-term liabilities	4,762,797	4,751,841
Total liabilities	4,982,588	5,710,664
Deferred inflow of resources:		
Deferred gain on bond refundings	82,247	134,067
Total deferred inflow of resources	82,247	134,067
Net position:		
Restricted for debt service	305,780	310,324
Total net position	\$ 305,780	310,324



Statements of Cash Flows

(Dollars in thousands)

For the years ended June 30,	2017	2016
<u>Cash flows from operating activities</u>		
Interest received on student loans	\$ 71,289	65,978
Principal received on student loans	988,038	1,109,297
Student loan purchases	(834,759)	(820,992)
Student loan sales, including net gains and losses	790,606	805,864
Other	-	154
Payment of operating expenses	(32,806)	(38,255)
Net cash provided by operating activities	982,368	1,122,046
<u>Cash flows from noncapital financing activities</u>		
Proceeds from the issuance of noncapital debt	925,568	-
Principal paid on noncapital debt	(1,656,985)	(1,068,908)
Interest paid on noncapital debt	(84,384)	(68,879)
Bond issuance costs	(8,164)	(2,066)
Other	(68,774)	(17,211)
Net cash used for noncapital financing activities	(892,739)	(1,157,064)
<u>Cash flows from investing activities</u>		
Interest received on investments	778	261
Net cash provided by investing activities	778	261
Net change in restricted cash and cash equivalents	90,407	(34,757)
Restricted cash and cash equivalents, beginning of period	218,582	253,339
Restricted cash and cash equivalents, end of period	\$ 308,989	218,582

There are nineteen separate trusts with parity ratios, a ratio of assets to liabilities. As of June 30, 2017, the trusts had parity ratios ranging from 1.026 to 2.010. Two of the nineteen trusts have minimum parity ratio requirements and as of June 30, 2017, the trusts complied with the minimum parity ratio requirements.



Note 12 – Blended Component Units

We consider the PHEAA Student Loan Trust I (the “Trust”), the PHEAA Student Loan Trust 2011-1 (“2011-1 Trust”), the PHEAA Student Loan Trust 2012-1 (“2012-1 Trust”), the PHEAA Student Loan Trust 2013-1 (“2013-1 Trust”), the PHEAA Student Loan Trust 2013-2 (“2013-2 Trust”), the PHEAA Student Loan Trust 2013-3 (“2013-3 Trust”), the PHEAA Student Loan Trust 2014-1 (“2014-1 Trust”), the PHEAA Student Loan Trust 2014-2 (“2014-2 Trust”), the PHEAA Student Loan Trust 2014-3 (“2014-3 Trust”), the PHEAA Student Loan Trust 2015-1 (“2015-1 Trust”), the PHEAA Student Loan Trust 2016-1 (“2016-1 Trust”), the PHEAA Student Loan Trust 2016-2 (“2016-2 Trust”) and the PHEAA Warehouse Facility Trust 2013-1 (“Warehouse Trust 2013-1”), collectively “PHEAA SLTs”, blended component units (“BCUs”) of the Foundation, and the PHEF a BCU of PHEAA.

The PHEAA SLTs are statutory trusts formed under the laws of the State of Delaware and they are legally separate entities. We consider the PHEAA SLTs component units of the Foundation, because of their material relationship with the Foundation. The PHEAA SLTs are BCUs of the Foundation, because they provide services entirely for the Foundation.

The PHEF is a component unit of PHEAA, because PHEAA appointed a voting majority of the PHEF’s governing board, and PHEAA has the ability to impose its will on PHEF. We considered PHEF a blended component unit of PHEAA, because PHEF no longer provided services to outside third parties in the form of grants and scholarships used to promote nursing education, but rather provided services entirely to us. On March 18, 2015, the Board of Directors authorized the dissolution of PHEF. As part of the dissolution of PHEF, all of the PHEF assets and all funds in its possession that had not been paid or set aside for PHEF’s obligations were to be paid to PHEAA, for its public purposes. On June 8, 2015, PHEF entered into an “Assignment of Rights Incident to Dissolution Agreement” with PHEAA. On October 29, 2015 the “Articles of Dissolution” were received by the PA Department of State Bureau of Corporations and Charitable Organizations, and PHEF was officially dissolved.

As legally separate entities, the student loan financings, net of the BCUs are non-recourse obligations to our unrestricted net position and to the Commonwealth.



In the statements that follow, we present condensed combining information of the BCUs.

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the year ended June 30, 2017		PHEAA SLTs	PHEF	Total BCUs
Interest revenue	\$	120,767	-	120,767
Interest expense		(24,738)	-	(24,738)
Net interest revenue		96,029	-	96,029
Provision for loan losses		(3,206)	-	(3,206)
Net interest revenue after provision for loan losses		92,823	-	92,823
Operating expenses		(33,190)	-	(33,190)
Operating income		59,633	-	59,633
Total transfers and financial aid		(30,955)	-	(30,955)
Changes in net position		28,678	-	28,678
Net position, beginning of period		188,264	-	188,264
Net position, end of period	\$	216,942	-	216,942

(Dollars in thousands)

For the year ended June 30, 2016		PHEAA SLTs	PHEF	Total BCUs
Interest revenue	\$	118,975	-	118,975
Interest expense		(24,072)	-	(24,072)
Net interest revenue		94,903	-	94,903
Provision for loan losses		(4,971)	-	(4,971)
Net interest revenue after provision for loan losses		89,932	-	89,932
Operating expenses		(32,196)	(37)	(32,233)
Operating income (loss)		57,736	(37)	57,699
Total transfers and financial aid		(12,509)	(229)	(12,738)
Changes in net position		45,227	(266)	44,961
Net position, beginning of period		143,037	266	143,303
Net position, end of period	\$	188,264	-	188,264

Statements of Net Position

(Dollars in thousands)

As of June 30, 2017	PHEAA SLTs	PHEF	Total BCUs
Current assets:			
Restricted cash and cash equivalents	\$ 146,677	-	146,677
Student loans receivable	761,153	-	761,153
Interest income receivable	65,086	-	65,086
Other assets	6	-	6
Total current assets	972,922	-	972,922
Long-term assets:			
Student loans receivable, net	3,490,489	-	3,490,489
Total long-term assets	3,490,489	-	3,490,489
Total assets	4,463,411	-	4,463,411
Total deferred outflow of resources	668	-	668
Current liabilities:			
Accounts payable and accrued expenses	16,661	-	16,661
Student loan financings	-	-	-
Total current liabilities	16,661	-	16,661
Long-term liabilities:			
Student loan financings, net	4,148,229	-	4,148,229
Total long-term liabilities	4,148,229	-	4,148,229
Total liabilities	4,164,890	-	4,164,890
Total deferred inflow of resources	82,247	-	82,247
Net position:			
Restricted for debt service	216,942	-	216,942
Total net position	\$ 216,942	-	216,942



(Dollars in thousands)

As of June 30, 2016	PHEAA SLTs	PHEF	Total BCUs
Current assets:			
Restricted cash and cash equivalents	\$ 121,270	-	121,270
Student loans receivable	769,078	-	769,078
Interest income receivable	61,867	-	61,867
Other assets	8	-	8
Total current assets	952,223	-	952,223
Long-term assets:			
Student loans receivable, net	3,939,517	-	3,939,517
Total long-term assets	3,939,517	-	3,939,517
Total assets	4,891,740	-	4,891,740
Total deferred outflow of resources	700	-	700
Current liabilities:			
Accounts payable and accrued expenses	17,579	-	17,579
Student loan financings	531,330	-	531,330
Total current liabilities	548,909	-	548,909
Long-term liabilities:			
Student loan financings, net	4,021,200	-	4,021,200
Total long-term liabilities	4,021,200	-	4,021,200
Total liabilities	4,570,109	-	4,570,109
Total deferred inflow of resources	134,067	-	134,067
Net position:			
Restricted for debt service	188,264	-	188,264
Total net position	\$ 188,264	-	188,264



Statements of Cash Flows

(Dollars in thousands)

For the year ended June 30, 2017		PHEAA SLTs	PHEF	Total BCUs
Net cash provided by operating activities	\$	536,690	-	536,690
Net cash used for noncapital financing activities		(511,814)	-	(511,814)
Net cash provided by investing activities		531	-	531
Net change in restricted cash and cash equivalents		25,407	-	25,407
Restricted cash and cash equivalents, beginning of period equivalents		121,270	-	121,270
Restricted cash and cash equivalents, end of period equivalents	\$	146,677	-	146,677

(Dollars in thousands)

For the year ended June 30, 2016		PHEAA SLTs	PHEF	Total BCUs
Net cash provided by (used for) operating activities	\$	921,182	(37)	921,145
Net cash used for noncapital financing activities		(955,871)	(229)	(956,100)
Net cash provided by investing activities		201	266	467
Net change in restricted cash and cash equivalents		(34,488)	-	(34,488)
Restricted cash and cash equivalents, beginning of period equivalents		155,758	-	155,758
Restricted cash and cash equivalents, end of period equivalents	\$	121,270	-	121,270

Note 13 – Net Position

We have net position that is invested in capital assets, which includes land, buildings and improvements, software, information technology equipment, and other tangible assets that are used in our operations. These capital assets are net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. As of June 30, 2017, net investment in capital assets amounted to \$88.2 million. As of June 30, 2016, net investment in capital assets amounted to \$79.1 million.

We have net position that is restricted for debt service that is held under various indentures related to financing our student loan portfolios. As of June 30, 2017, net position restricted for debt service amounted to \$305.8 million. As of June 30, 2016, net position restricted for debt service amounted to \$310.3 million.

We have net position that is restricted for financial aid grant programs, because of the Commonwealth of Pennsylvania grants and federal grants that relate to specific programs. The net position is restricted until we



disburse program-related grants. As of June 30, 2017, net position restricted for financial aid grant programs amounted to \$29.3 million. As of June 30, 2016, net position restricted for financial aid grant programs amounted to \$52.1 million.

We have net position that is unrestricted, which is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Under Commonwealth law, our purpose is to increase higher education opportunities for Pennsylvania residents. Net position that we report as unrestricted are statutorily restricted to our purpose. The Higher Education Amendments of 1998 also restricts our use of net position related to FFEL guaranty activities to fulfilling our guaranty responsibilities and other student financial aid related activities selected by us. Because that restriction is consistent with our statutory purpose, we consider net position related to those activities to be unrestricted. As of June 30, 2017, unrestricted net position amounted to \$263.7 million of which net position related to the guaranty activities was \$107.4 million. As of June 30, 2016, unrestricted net position amounted to \$310.2 million of which net position related to the guaranty activities was \$156.9 million.

Note 14 – Risk Management, Contingencies, and Legal Proceedings

Risk Management and Contingencies

The current heightened regulatory environment for student and consumer lenders and servicers has resulted in significant additional governmental scrutiny, and we may be adversely impacted by the results of such additional scrutiny. The regulatory environment with respect to the student loan industry is evolving, and governmental or regulatory officials may exercise broad discretion in deciding how to interpret and apply applicable laws, rules, regulations and standards. From time to time and in the past, we have received formal and informal inquiries, subpoenas, civil investigative demands from various government regulatory and investigatory authorities about the loans we service or own, our operations, borrowers or our compliance with laws, rules, regulations or standards. We expect to continue to receive similar demands from time to time in the future and an adverse outcome in one or more of these matters could be material to our operations, financial condition, cash flows and/or reputation. Any determination that our operations or activities or the activities of our employees are not in compliance with existing laws, rules, regulations or standards, could result in payment delays, the imposition of substantial fines, a requirement of restitution, interruptions of our respective operations, the reduction or loss of supplier, vendor or other third party relationships, termination of necessary licenses or permits, or similar results, all of which could potentially harm our respective operations, financial condition, cash flows and/or reputation. Even if any reviews, inquiries or investigations do not result in these types of determinations, such reviews, inquiries and investigations could cause us to incur substantial costs, require us to change our operating or servicing practices, or create negative publicity, which could also harm our respective operations, financial condition, business relationships or reputation. To date, there have been no material supervisory or enforcement actions or findings.

Federal programs in which we participate are subject to audit in accordance with the provisions of the U.S. Office of Management and Budget's ("OMB") Uniform Guidance, which superseded OMB's Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. The provisions of the Uniform Guidance do not limit the authority of ED or other federal audit officials to perform, or contract for, audits and evaluations of federal financial assistance programs. Therefore, our operations in current and prior years are subject to audit. We believe we are in substantial compliance with applicable federal regulations and that any adjustment because of future audits will not be material.

Legal Proceedings

Jon H. Oberg v. Kentucky Higher Ed. Student Loan Corp., et. al

As previously reported, in *U.S. ex. rel. Jon H. Oberg v. Kentucky Higher Ed. Student Loan Corp., et. al.*, Dr. Jon H. Oberg, a former U.S. Department of Education employee, filed a False Claims Act ("FCA") case in the United States District Court for the Eastern District of Virginia against several public and private student loan financing entities. PHEAA was served with a copy of Oberg's First Amended Complaint on or about September 29, 2009.



The First Amended Complaint alleged that the defendants submitted claims to the U.S. Department of Education for special allowance payments providing a 9.5% floor on the return on certain loans, including loans that were not eligible for such a special allowance. It further alleged that PHEAA in particular obtained approximately \$92 million in unlawful payments from the Department of Education. The FCA provides for treble damages and civil penalties.

PHEAA filed a motion to dismiss the action, and an order was issued by the district court dismissing PHEAA, the Vermont Student Assistance Corporation, the Kentucky Higher Education Student Loan Corporation, and the Arkansas Student Loan Authority (the “State Defendants”) on December 1, 2009. The district court held that each of the State Defendants was not a “person” subject to liability under the FCA because each was an agency of its respective state. Dr. Oberg and the United States litigated and then settled with the other (non-State) defendants remaining in the case.

Dr. Oberg appealed the December 1, 2009 order of dismissal. The Court of Appeals for the Fourth Circuit (the “Fourth Circuit”) vacated the dismissal and remanded the case on the ground that the district court did not employ the proper analysis in determining whether PHEAA, among others, is a state agency subject to suit under the FCA. The Fourth Circuit concluded that a court should employ the Eleventh Amendment “arm-of-the-state” analysis in determining if an entity is properly regarded as a “person,” for FCA purposes, that is subject to suit under the FCA.

On remand, Oberg filed a Fourth Amended Complaint, which PHEAA moved to dismiss, again arguing it is not a person subject to liability under the FCA. The district court granted PHEAA’s motion, finding PHEAA is an arm of the Commonwealth of Pennsylvania and therefore not a “person” subject to liability under the FCA.

Dr. Oberg appealed a second time. The Fourth Circuit vacated the dismissal of the claims against PHEAA and remanded the case to the district court “to permit limited discovery on the question of whether PHEAA is ‘truly subject to sufficient state control to render [it] a part of the state’.” On remand, following discovery, PHEAA moved for summary judgment, arguing that there was no genuine issue of material fact and PHEAA was entitled to judgment as a matter of law because discovery confirmed that it is an arm of the Commonwealth. The district court granted the motion on January 16, 2015.

Dr. Oberg appealed a third time. On October 21, 2015, the Fourth Circuit reversed and held that, as a matter of law, PHEAA is not an arm of the state and is a “person” subject to suit under the FCA.

On November 17, 2015, the Fourth Circuit denied PHEAA’s request for a rehearing by all of the judges of the Fourth Circuit (a “rehearing *en banc*”). On February 16, 2016, PHEAA filed a *petition for writ of certiorari* with the United States Supreme Court (“Supreme Court”). On May 16, 2016, the Supreme Court invited the Solicitor General of the United States to file a brief regarding whether certiorari should be granted in this case. PHEAA met with the Solicitor General on July 26, 2016, to present its position in favor of certiorari. On January 9, 2017, the Supreme Court denied PHEAA’s petition for writ of certiorari. As such, the matter was returned to the trial court and will proceed on the merits. Discovery is closed and PHEAA filed a motion for summary judgment on August 28, 2017. As of June 30, 2017, and through the date of this report, we believe it is remote that a loss contingency exists, and we will continue to contest this matter vigorously.

Commonwealth of Massachusetts

As a larger participant defined by the Consumer Financial Protection Bureau (“CFPB”) in the market for student loan servicing, we are the subject of various subpoenas, requests, and actions by various state and federal regulatory bodies. On August 23, 2017, the Commonwealth of Massachusetts (“Massachusetts”), by and through its Attorney General, brought enforcement action pursuant to the Massachusetts Consumer Protection Act, and the Consumer Financial Protection Act against the Pennsylvania Higher Education Assistance Agency, d/b/a Fedloan Servicing (“PHEAA”). PHEAA does not agree with the allegations made by the Massachusetts Attorney General’s Office with regards to their findings. However, PHEAA remains committed to appropriately resolving any outstanding borrower issues while following the U.S. Department of Education’s policies, procedures, and regulations as mandated by the PHEAA’s federal contracts. PHEAA will continue working with the U.S. Department of Education’s Office of



Federal Student Aid (“FSA”) to help resolve any issue identified by the Massachusetts Attorney General. Lastly, as of the date of this report, PHEAA believes that the risk of loss is remote and PHEAA will continue to contest this matter vigorously.

Lastly, we are involved in various legal matters in the normal course of business. We have considered the available information on these legal matters, and the criteria for a loss contingency, as defined by GASB, does not exist as of June 30, 2017 and through the date of this report.



Required Supplementary Information

The schedules that follow are required supplementary information and are presented as of and for the year ended December 31, 2016 (**measurement date**) and as of and for the year ended June 30, 2017 (**PHEAA's fiscal year-end**):

Schedule of PHEAA's Proportionate Share of Net Pension Liability

As of and for the years ended December 31 (measurement date)

(Dollars in thousands)

Calendar year end	PHEAA's proportionate (percentage) share of collective net pension liability	PHEAA's proportionate (amount) share of collective net pension liability	PHEAA's covered employee payroll	PHEAA's proportionate share of collective net pension liability as a percentage of covered employee payroll	Fiduciary (SERS) net position as a percentage of the total pension liability
2016	2.46%	\$474,743	\$165,462	286.9%	57.8%
2015	2.42%	\$440,673	\$164,947	267.2%	58.9%
2014	2.18%	\$323,866	\$141,621	228.7%	64.8%

The "Schedule of PHEAA's Proportionate Share of Net Pension Liability" presented above is to illustrate the required 10-year trend of information. However, until we can compile a full 10-year trend of information, we are presenting the information for which information was available.

Schedule of PHEAA's Contributions

As of and for the years ended June 30 (PHEAA's fiscal year-end)

(Dollars in thousands)

Fiscal year end	Required contributions	PHEAA's contributions recognized by the pension plan	Contribution excess/(deficiency)	PHEAA's covered employee payroll	PHEAA's contributions as a percentage of covered employee payroll
2017	\$41,994	\$41,994	-	\$169,725	24.7%
2016	\$36,074	\$36,074	-	\$165,650	21.8%
2015	\$26,027	\$26,027	-	\$149,629	17.4%

The "Schedule of PHEAA's Contributions" presented above is to illustrate the required 10-year trend of information. However, until we can compile a full 10-year trend of information, we are presenting the information for which information was available.