Annual Financial Report
June 30, 2013 and 2012

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

This discussion and analysis of the financial performance of the Pennsylvania Higher Education Assistance Agency (PHEAA) is required supplementary information. It introduces the basic financial statements and provides an analytical overview of our financial activities. Please read it in conjunction with the 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 on behalf of the Commonwealth of Pennsylvania (Commonwealth) each year, without taxpayer support. Our business earnings fund the administration of this program ensuring that every appropriated dollar goes directly to students.

Our debt management professionals, our use of technology, and our websites, YouCanDealWithIt.com and EducationPlanner.org, have reduced financial risk for our customers and ensured that funds remain accessible to all students. Each year the Department of Education (ED) publishes cohort default rates for lenders and guaranty agencies, and ED calculates the cohort default rate based on the percentage of a lender's or guarantor's student borrowers who enter repayment on Federal Family Education Loan (FFEL) program loans during a federal fiscal year (October 1 - September 30) and default before the end of the next fiscal year. Our two-year cohort default rate for the most recent year available, fiscal year 2011 was 6.7%. Our two-year cohort default rate for fiscal year 2010 was 6.1%, which was better than the national industry average of 9.1%. Our two-year cohort default rate for fiscal year 2009 was 6.0%, which was better than the national industry average of 8.8%.

We facilitate the guarantee of Federal Stafford, PLUS and Consolidation loans originated before July 1, 2010. For the year ended June 30, 2013, the average original principal balance outstanding of student loans guaranteed was $39.4 billion compared to $43.5 billion in 2012 and $47.0 billion in 2011.

We service student loans that we own and loans owned by third parties through our Commercial Servicing, FedLoan Servicing (FLS), and Remote Servicing lines of business. Our Commercial Servicing line of business services alternative and FFEL program loans. Our FLS line of business services federally owned FFEL and William D. Ford (Direct Loan) program loans. Our Remote Servicing line of business provides our system to guarantors, other servicers, and Not for Profit (NFP) servicers to use in their internal servicing operations.

Public Service Benefits

The following table highlights the public service benefits and the operating expenses incurred by us.

For the years ended June 30 (in thousands)		2013	2012	2011
Self-funded				
Pennsylvania State Grant Supplement	$	**75,000**	50,002	-
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds		**4,434**	626	871
Costs of operating state and federal governmental programs		**13,552**	12,603	12,698
Other public service activities and outreach		**3,587**	3,174	3,935
		96,573	66,405	17,504
Financial support funded by our business partners				
Keystone loan program origination fees and benefits paid on behalf of borrowers		**24**	122	105
	$	**96,597**	66,527	17,609

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

- On June 20, 2013, the Board of Directors approved the following allocations for fiscal year 2013-2014:
  - Supplement to the Pennsylvania State Grant Program - $75.0 million;
  - Supplement to the Pennsylvania Distance Education Program - $10.0 million; and
  - Supplement to the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program - $5.0 million.

- On June 30, 2013, the Governor of Pennsylvania signed the budget for fiscal year 2013-2014 and the following funding levels were approved:
  - Pennsylvania State Grant Program - $344.9 million;
  - Institutional Assistance Grant - $24.4 million;
  - Matching Funds Grant - $12.5 million;
  - Higher Education for the Disadvantaged - $2.2 million;
  - Cheyney University Keystone Academy - $1.5 million;
  - Horace Mann Bond-Leslie Pickney Hill Scholarship for outreach and recruitment activities at Lincoln and Cheyney Universities - $534.0 thousand;
  - Pennsylvania Internship Program Grants - $350.0 thousand; and
  - Higher Education of Blind or Deaf - $47.0 thousand.

- The Pennsylvania State Grant Program is the largest of the Commonwealth supported student aid programs with approximately 156 thousand projected recipients and the maximum award is $4,348 for the 2013-2014 award year.

  During the 2012-2013 award year, the Pennsylvania State Grant Program supported approximately 171 thousand recipients and the maximum award was $4,348. During the 2012-2013 award year, the Board of Directors approved a $75.0 million allocation to supplement the Pennsylvania State Grant Program and $5 million for the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program. As of June 30, 2013, we have transferred $75.0 million from the Pennsylvania State Grant Supplement fund (Unrestricted) to the Pennsylvania State Grant Program fund (Restricted for Financial Aid), and disbursed $4.4 million, net of refunds, from the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program

Supplement fund (Unrestricted). As of June 30, 2013, $566.0 thousand was unspent in the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement.

During the 2011-2012 award year, the Pennsylvania State Grant Program supported approximately 188 thousand recipients and the maximum award was $4,348. During the 2011-2012 award year, the Board of Directors approved and PHEAA supplemented $50.0 million to the Pennsylvania State Grant Program.

- 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 Gratuity 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.

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 guaranty activities, servicing activities, and student loan holdings.

Guaranty Activities

We manage the Federal Student Loan Reserve Fund (Federal Fund) for ED, so there is enough money to pay lenders when their normal collection efforts fail and a borrower defaults on a student loan. For more information on the Federal Fund, see the section titled "Federal Student Loan Reserve Fund (Federal Fund)" within the MD&A.

We facilitate the guarantee of at least 97% of the principal and accrued interest on Stafford, PLUS, 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.

ED reimburses the Federal Fund and the reinsurance rates vary based upon the default rates of our portfolio of guaranteed loans and the disbursement date of the loan. The following outlines reinsurance rates, which are based on loan disbursement dates:

▪ 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%

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.

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:

- A judgment has been obtained on the loan;
- Default claims were filed on the loan under 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.

In order to facilitate the sale of the rehabilitated student loans to eligible lenders, we purchase and sell rehabilitated student loans.

Once the borrower meets the above program requirements, the borrower regains all benefits of the loan program, including any remaining deferment eligibility.

On December 12, 2012, ED designated us the guarantor for the State of Georgia effective April 1, 2013. On March 31, 2013, we transferred $687.7 million of student loans from the Georgia Higher Education Assistance Corporation (GHEAC) on to our guaranty system.

Servicing Activities

We service student loans that we own and loans owned by third parties through our Commercial Servicing, FLS, and Remote Servicing lines of business. Our Remote Servicing line of business provides our systems to guarantors, other servicers, and NFP servicers to use in their internal servicing operations.

Our Commercial Servicing line of business services student loans that were originated under the FFEL program, prior to July 1, 2010, and various alternative loan programs. Our FLS line of business services student loans that were originated under the Direct Loan program and the FFEL program, which are owned by ED. The FFEL and the Direct Loan programs are federal programs that allow undergraduate or graduate students at eligible postsecondary schools to obtain loans. Furthermore, as a servicer, we are responsible for maintaining and pursuing collections on student loans.

There are four types of loans under the FFEL and the Direct Loan programs:

- Subsidized Stafford – The federal government pays the interest on these loans while the student is in school, during the grace period, and during deferments;
- Unsubsidized Stafford – The student is responsible for all interest;

- PLUS – This is a supplemental loan to parents and graduate students; and
- Consolidation – This allows the borrower to combine Stafford and certain other education-related loans, fix the rate of interest on the loans, and extend the repayment period.

Student Loan Holdings

The Student Aid and Fiscal Responsibility Act (SAFRA) terminated our authority to originate new loans under the FFEL program after June 30, 2010. All new Stafford, PLUS and Consolidation student loans are originated under the Direct Loan program.

We continue to earn interest subsidies and special allowance payments based on the types of student loans held within our 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 while the student is a qualified student, during a 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".

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.

On December 23, 2011, President Obama signed into law the Consolidated Appropriations Act, 2012 (Public Law 112-74), which provided that loan holders or entities that hold beneficial ownership interests in student loans originated under the FFEL program for which the first disbursement was made on or after January 1, 2000, and before July 1, 2010, could elect to have payments of special allowance (a federal interest rate subsidy) for the three month period ended June 30, 2012, and for each subsequent three month period, calculated using an index based on the average of the bond equivalent rates of the 1-month LIBOR for United States dollars in effect for each of the days in such quarter as compiled and released by the British Bankers Association, instead of an index based on the average of the bond equivalent rates of the quotes of the 3-month commercial paper (financial) 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 three month period.

After obtaining necessary consents of bondholders, noteholders and other third parties, we made the election to have special allowance payments (SAP) determined using the LIBOR based index described above (the "LIBOR Election"), however, we filed for, and obtained, an exception from this LIBOR Election from ED with respect to otherwise eligible student loans pledged as collateral for certain of our outstanding bonds and notes for which the requisite percentage amount of bondholder or noteholder consent was not received with respect to making the LIBOR Election. Student loans subject to the exception will continue to have SAP determined using the index based on 3-month commercial paper (financial) rates, subject to future amendments to the Higher Education Act. As a condition to making an effective LIBOR Election, ED required us to waive all rights to special allowance calculated using the 3-month commercial paper-based index.

Description of the Basic Financial Statements

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 and liabilities. We own or control assets, and we owe liabilities. Net position remains after assets are used to satisfy liabilities. These statements report our assets, liabilities 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.

We are financed and operated similar to a private business enterprise. We follow the economic resources measurement focus and accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. While private business enterprises follow the accounting guidance issued by the Financial Accounting Standards Board (FASB), we follow the guidance issued by the Governmental Accounting Standards Board (GASB).

Condensed Financial Information

Statements of Revenues, Expenses and Changes in Net Position

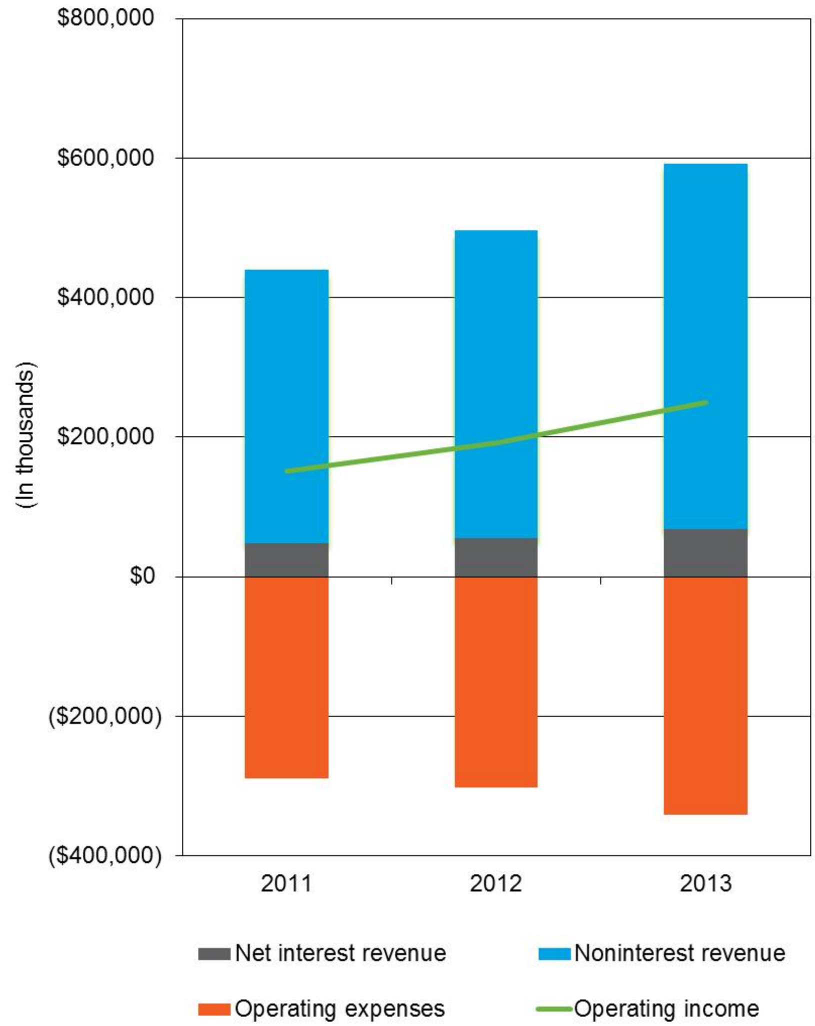
For the years ended June 30 (in thousands)		2013	2012	2011
Student loan interest revenue	$	**138,252**	153,722	179,615
Investment interest revenue		**8,615**	5,454	10,154
Interest expense on student loan financings and notes and bonds payable		**(72,297)**	(98,304)	(131,826)
Interest expense on other financings		**(1,534)**	(3,383)	(5,061)
Net interest revenue		**73,036**	57,489	52,882
Provision for loan losses		**(5,069)**	(3,086)	(4,535)
Net interest revenue after provision for loan losses		**67,967**	54,403	48,347
Total noninterest revenue		**524,369**	441,087	391,742
Operating revenues		**592,336**	495,490	440,089
Operating expenses		**(340,318)**	(303,132)	(288,934)
Operating income		**252,018**	192,358	151,155
Non-operating (losses) and gains		**(79)**	76	(539)
Income before grants and financial aid		**251,939**	192,434	150,616
Total grants and financial aid		**(96,112)**	(79,848)	24,140
Change in net position	$	**155,827**	112,586	174,756

Statements of Net Position

As of June 30 (in thousands)		2013	2012	2011
Current assets:				
Cash, cash equivalents, and investments (restricted and unrestricted)	$	**842,416**	910,482	827,904
Student loans receivable, net		**1,067,929**	928,297	1,086,961
Other assets		**330,291**	285,799	269,541
Total current assets		**2,240,636**	2,124,578	2,184,406
Long-term assets:				
Student loans receivable, net		**6,576,773**	6,611,508	7,965,088
Other assets		**107,289**	95,190	91,107
Total long-term assets		**6,684,062**	6,706,698	8,056,195
Total assets		**8,924,698**	8,831,276	10,240,601
Current liabilities:				
Student loan financings and notes and bonds payable, net		**165,963**	120,000	135,800
Other liabilities		**231,049**	227,409	210,093
Total current liabilities		**397,012**	347,409	345,893
Long-term liabilities:				
Student loan financings and notes and bonds payable, net		**7,509,561**	7,569,232	9,071,825
Other liabilities		**66,491**	118,828	139,662
Total long-term liabilities		**7,576,052**	7,688,060	9,211,487
Total liabilities		**7,973,064**	8,035,469	9,557,380
Net position:				
Net investment in capital assets		**60,492**	55,557	53,264
Restricted for debt service		**295,895**	201,741	253,880
Restricted for financial aid grant programs		**36,647**	52,243	81,307
Unrestricted		**558,600**	486,266	294,770
Total net position	$	**951,634**	795,807	683,221

Results of Operations

Years ended June 30



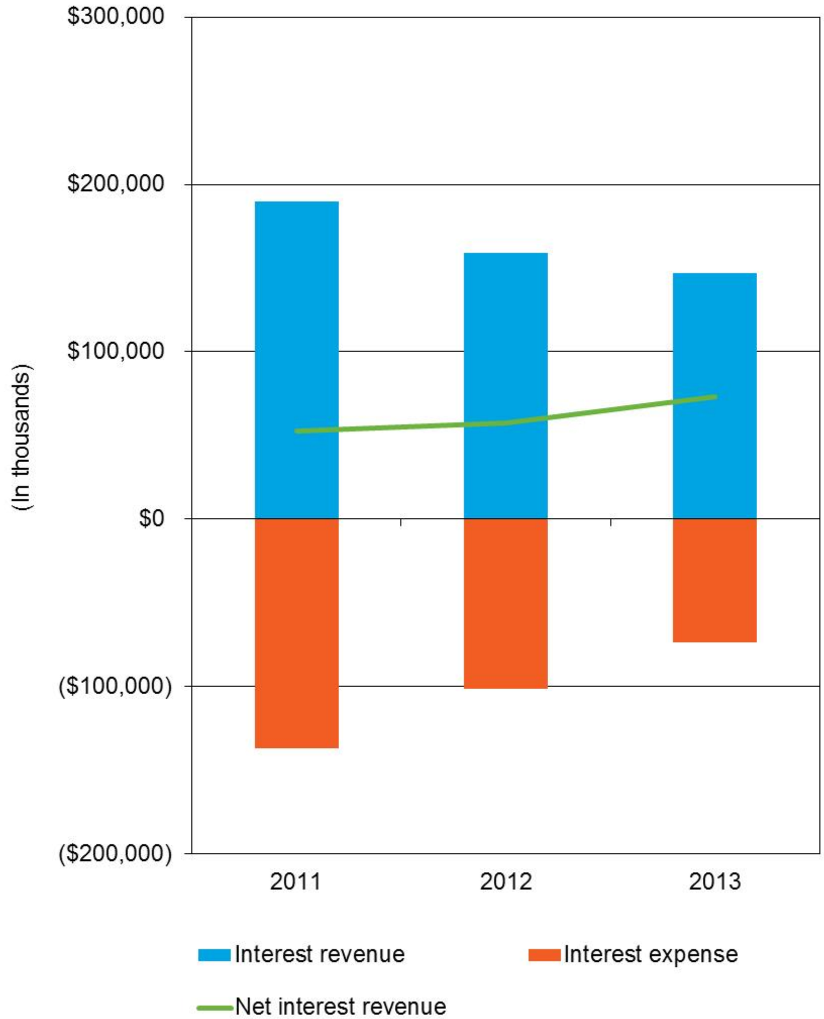
Operating income for the year ended June 30, 2013, was $252.0 million, a 31.0% increase from operating income of $192.4 million in 2012. Operating revenues were $592.3 million in 2013, a 19.5% increase from $495.5 million in 2012. Net interest revenue after provision for loan losses was $68.0 million in 2013, a 25.0% increase from $54.4 million in 2012. Noninterest revenue was $524.4 million in 2013, an 18.9% increase from $441.1 million in 2012. Operating expenses were $340.3 million in 2013, a 12.3% increase from $303.1 million in 2012.

Operating income for the year ended June 30, 2012, was $192.4 million, a 27.2% increase from operating income of $151.2 million in 2011. Operating revenues were $495.5 million in 2012, a 12.6% increase from $440.1 million in 2011. Net interest revenue after provision for loan losses was $54.4 million in 2012, a 12.6% increase from $48.3 million in 2011. Noninterest revenue was $441.1 million in 2012, a 12.6% increase from $391.7 million in 2011. Operating expenses were $303.1 million in 2012, a 4.9% increase from $288.9 million in 2011.

A more detailed explanation of the results of operations follows.

Net Interest Revenue

Years ended June 30



Net interest revenue results primarily from the interest rate margin in our portfolio of student loans, although we have investments and debt not related to those student loans that can also create net interest revenue.

For the year ended June 30, 2013, net interest revenue was $73.0 million, a 27.0% increase from $57.5 million in 2012. The increase in net interest revenue was due to an increase in investment interest revenue and a decrease in interest expense on student loan financings and notes and bonds payable. The increase in investment interest revenue was due to unrealized losses on investments recorded during the year ended June 30, 2012, compared to unrealized gains recorded during the same period ended during 2013. The decrease in interest expense on student loan financings and notes and bonds payable was mainly due to the decrease in auction rate security interest expense due to the purchase and cancellation of bonds from the 1997 Master Trust through our various lines of credit and from our unrestricted cash reserves; and the repayment of student loan variable rate funding notes as part of the bond refunding that took place on November 14, 2012.

For the year ended June 30, 2012, net interest revenue was $57.5 million, an 8.7% increase from net interest revenue of $52.9 million in 2011. The increase in net interest revenue was mainly due to a decrease in interest expense on student loan financings and notes and bonds payable due to the bond refunding that took place on July 14, 2011.

The following table shows the average balances and rates earned on interest earning assets and the average balances and rates paid on interest bearing liabilities.

For the years ended June 30, (Balances in thousands)		**2013** Balances	**Rate**		2012 Balances	Rate		2011 Balances	Rate
Average interest earning assets									
Student loans receivable, net	$	**7,111,520**	**1.94%**	$	8,400,364	1.83%	$	9,587,921	1.87%
Investments		**852,220**	**1.01%**		817,752	0.67%		747,467	1.36%
	$	**7,963,740**	**1.84%**	$	9,218,116	1.73%	$	10,335,388	1.84%
Average interest bearing liabilities									
Student loan financings and notes and bonds payable, net	$	**7,193,339**	**1.01%**	$	8,520,115	1.15%	$	9,774,795	1.35%
Capital and other financings, net		**72,783**	**2.11%**		125,165	2.70%		161,242	3.14%
	$	**7,266,122**	**1.02%**	$	8,645,280	1.18%	$	9,936,037	1.38%
Net interest margin			**0.82%**			0.55%			0.46%

For the year ended June 30, 2013, the decrease in the balance of our average interest bearing assets was due to our decreasing student loan portfolio.

For the year ended June 30, 2013, the decrease in the balance and rate of our average interest bearing liabilities was primarily due to the purchase and cancellation of bonds from the 1997 Master Trust and various bond refundings that occurred during the year; scheduled debt payments; and the early extinguishment of $45.4 million of other financing debt.

For the year ended June 30, 2012, the decrease in the balance of our average interest bearing assets was due to our decreasing student loan portfolio, and the sale of $462.9 million of student loans that were part of the bond refunding that took place on July 14, 2011.

For the year ended June 30, 2012, the decrease in the balance and rate of our average interest bearing liabilities was due to our scheduled debt payments and the bond refunding that took place on July 14, 2011. On July 14, 2011, we purchased and cancelled $1.9 billion of taxable auction rate security bonds and $433.6 million of tax-exempt auction rate security bonds from the 1997 Master Trust, and issued $1.7 billion of floating rates notes with an interest rate of 3-month LIBOR plus 1.10%.

See **Note 8 – Notes and Bonds Payable and Other Financings** for more details on our student loan holdings and weighted-average interest rates.

The following table shows the net interest margin on student loans.

For the years ended June 30,	**2013**	2012	2011
Student loan yields	**3.04%**	2.98%	3.04%
Consolidation loan rebate fees	**(0.80)**	(0.76)	(0.72)
Premium amortization	**(0.24)**	(0.32)	(0.37)
Lender origination fees	**(0.06)**	(0.07)	(0.08)
Student loan interest revenue	**1.94%**	1.83%	1.87%
Student loan financings and notes and bonds payable interest expense	**(1.01)**	(1.15)	(1.35)
Net interest margin on student loans	**0.93%**	0.68%	0.52%

For the year ended June 30, 2013, the increase in the rate on student loan interest revenue was mainly due to the decrease in the scheduled amortization of purchased premium. The decrease in the rate on student loan financings and notes and bonds payable interest expense was due to the past bond refundings in which we refunded student loan debt with higher rates of interest for student loan debt with lower rates of interest.

For the year ended June 30, 2012, the decrease in the rate on student loan interest revenue was due to the decrease in the student loan yield as a result of lower average balances on interest earning assets. The decrease in the rate on student loan financings and notes and bonds payable interest expense was due to the bond refundings in which we refunded student loan debt with higher rates of interest for student loan debt with lower rates of interest.

Although the amounts we earn on student loans involve interpreting and complying with complicated regulations issued by ED, our portfolio of student loans consists of variable-rate loans. As of June 30, 2013 and 2012, 3% of the variable-rate loans change was based upon changes in the 91-day U.S. Treasury Bill rate, 19% of the variable-rate loans change was based upon changes in the 3-month financial commercial paper rate, and 78% of the variable-rate loans was based upon changes in the 1-month LIBOR. As of June 30, 2011, 3% of the variable-rate loans change was based upon changes in the 91-day U.S. Treasury Bill rate and 97% of the variable-rate loans change was based upon changes in the 3-month financial commercial paper rate. The change in the interest rate mix of our variable-rate loans was due to the LIBOR Election we made on April 1, 2012. See the section titled "Student Loan Holdings", page 7, for more details on the LIBOR Election.

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.

For the years ended June 30 (in thousands)		**2013 vs. 2012 Increase (decrease) attributable to change in** **Increase (decrease)**	**Rate**	**Volume**		2012 vs. 2011 Increase (decrease) attributable to change in Increase (decrease)	Rate	Volume
Student loan interest revenue	$	(15,470)	8,115	(23,585)	$	(25,893)	(3,645)	(22,248)
Investment interest revenue		3,161	2,931	230		(4,700)	(5,655)	955
		(12,309)	11,046	(23,355)		(30,593)	(9,300)	(21,293)
Student loan financings and notes and bonds payable interest expense		(26,007)	(10,699)	(15,308)		(33,522)	(16,601)	(16,921)
Other financings interest expense		(1,849)	(433)	(1,416)		(1,678)	(546)	(1,132)
		(27,856)	(11,132)	(16,724)		(35,200)	(17,147)	(18,053)
Net interest revenue	$	15,547	22,178	(6,631)	$	4,607	7,847	(3,240)

For the year ended June 30, 2013, the decrease in the volume of our student loan interest revenue was due to a decreasing student loan portfolio. The increase in the rate of our investment interest revenue was due to unrealized gains earned on our investments during the current year compared to unrealized losses earned on our investments during the prior year.

For the year ended June 30, 2013, the decrease in the rate and volume of our student loan financings and notes and bonds payable interest expense was due to scheduled debt payments, the purchase and cancellation of auction rate security bonds from the 1997 Master Trust, and lower interest rates due to previous bond refundings.

For the year ended June 30, 2012, the decrease in the volume of our student loan interest revenue was due to a decreasing student loan portfolio. The decrease in the rate of our investment interest revenue was due to lower returns earned on our investments.

For the year ended June 30, 2012, the decrease in the rate and volume of our student loan financings and notes and bonds payable interest expense was due to a $2.3 billion bond refunding that took place July 14, 2011. The decrease in the rate and volume of our other financings interest expense was due to management exercising a call option on $15.0 million of Capital Acquisition Refunding Bonds, Series 2001 on April 2, 2012.

For more details on our debt financing activity, see the debt financing activity table within the section titled "Debt Activity and Capital Assets" of the MD&A.

Interest Rate Risk Management

Student loans are generally variable-rate assets, so we generally fund them with variable-rate debt.

In the table that follows, we categorize variable-rate assets and liabilities by reset date and fixed-rate assets and liabilities by their maturity dates. An interest rate gap is the difference between the volumes of assets and liabilities maturing or re-pricing during specific future time intervals. The above mentioned table includes only those assets and liabilities related to our student loan financings and notes and bonds payable. However, as of June 30, 2013, we had $612.8 million of cash, cash equivalents and investments and $36.3 million of student loans, as well as other assets and liabilities, not included in the previously mentioned table, because they do not relate to the student loan financings and notes and bonds payable.

If a period gap is positive, it means there are more assets than liabilities re-pricing during the period. If interest rates rise in a period with a positive gap, net interest revenue will increase. Conversely, if interest rates fall in a period with a positive gap, net interest revenue will decrease.

The opposite is true when the period gap is negative. This occurs when more liabilities than assets are re-pricing during the period. If interest rates rise in a period with a negative gap, net interest revenue will decrease. If interest rates fall in a period with a negative gap, net interest revenue will increase.

The gap analysis that follows reflects rate-sensitive positions as of June 30, 2013, and is not necessarily reflective of positions that existed throughout the period.

		Interest rate sensitivity period					
As of June 30, 2013 (in thousands)		**3 months or less**	**3 months to 6 months**	**6 months to 1 year**	**1 to 2 years**	**2 to 5 years**	**Over 5 years**
Assets							
Restricted cash and cash equivalents	$	229,620	-	-	-	-	-
Student loans, net		7,395,713	68,413	141,496	2,113	449	201
Other assets		88,965	15,822	7,552	7,658	13,959	26,091
Total assets		7,714,298	84,235	149,048	9,771	14,408	26,292
Liabilities							
Student loan financings and notes and bonds payable, net		7,514,224	161,300	-	-	-	-
Other liabilities		26,614	19	-	-	-	-
Total liabilities		7,540,838	161,319	-	-	-	-
Net position							
Restricted for debt service	$	-	-	-	-	-	295,895
Period gap	$	173,460	(77,084)	149,048	9,771	14,408	(269,603)
Cumulative gap	$	173,460	96,376	245,424	255,195	269,603	-
Ratio of interest-sensitive assets to interest-sensitive liabilities and net position		102.3 %	52.2 %	-%	-%	-%	8.9 %
Ratio of cumulative gap to total assets		2.2 %	1.2 %	3.1 %	3.2 %	3.4 %	- %

The table below includes only those assets and liabilities related to our student loan financings and notes and bonds payable. However, as of June 30, 2012, we had $638.2 million of cash, cash equivalents and investments and $35.7 million of student loans, as well as other assets and liabilities, not included in the table below, because they do not relate to the student loan financings and notes and bonds payable.

The gap analysis that follows reflects rate-sensitive positions as of June 30, 2012, and is not necessarily reflective of positions that existed throughout the period.

		Interest rate sensitivity period					
As of June 30, 2012 (in thousands)		**3 months or less**	**3 months to 6 months**	**6 months to 1 year**	**1 to 2 years**	**2 to 5 years**	**Over 5 years**
Assets							
Restricted cash and cash equivalents	$	272,286	-	-	-	-	-
Student loans, net		7,226,648	90,007	178,109	6,559	2,490	303
Other assets		76,996	14,993	8,001	7,876	14,267	20,398
Total assets		7,575,930	105,000	186,110	14,435	16,757	20,701
Liabilities							
Student loan financings and notes and bonds payable, net		7,569,232	120,000	-	-	-	-
Other liabilities		27,605	355	-	-	-	-
Total liabilities		7,596,837	120,355	-	-	-	-
Net position							
Restricted for debt service	$	-	-	-	-	-	201,741
Period gap	$	(20,907)	(15,355)	186,110	14,435	16,757	(181,040)
Cumulative gap	$	(20,907)	(36,262)	149,848	164,283	181,040	-
Ratio of interest-sensitive assets to interest-sensitive liabilities and net position		99.7 %	87.2 %	-%	-%	-%	10.3 %
Ratio of cumulative gap to total assets		(0.3) %	(0.5) %	1.9 %	2.1%	2.3 %	- %

Allowance for Loan Losses

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, such as private, uninsured, and Health Education Assistance Loan (HEAL). 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 based upon 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 loan program on or after July 1, 2010.

This allowance 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**.

In making our estimates, we consider the trend in default rates in our portfolio. 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 discussed above.

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

As of June 30 (in thousands)		**2013**	2012	2011
Balance at beginning of period	$	**11,770**	11,290	12,205
Provision for losses		**5,035**	4,194	3,635
Charge-offs		**(4,184)**	(3,714)	(4,550)
Balance at end of period	$	**12,621**	11,770	11,290
Ending balance of FFEL student loans	$	**7,551,035**	7,386,186	8,836,594
Allowance as a percentage of ending balance of student loans		**0.17%**	0.16%	0.13%

As of June 30, 2013, we believe the allowance for loan losses is adequate to cover the inherent losses on our FFEL student loan portfolio.

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 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 delinquency status is no longer current and/or in-litigation. Included with private loans are loans formerly guaranteed by The Education Resource Institute, Inc. (TERI). For those loans formerly guaranteed by TERI, we record a provision for loan losses on 100% of the loan balances that have a payment delinquency status of 121 days and greater, and those loans classified as "claims filed but not paid".

- 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.

These allowances along with allowance for losses on FFEL program loans are included in the section titled "Allowance for loan losses" in **Note 6 – Student Loans Receivable, net**.

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

As of June 30 (in thousands)		**2013**	2012	2011
Balance at beginning of period	$	**4,400**	5,439	4,413
Provision for losses		**34**	(1,108)	900
Recoveries		**29**	69	126
Balance at end of period	$	**4,463**	4,400	5,439
Ending balance of non-FFEL student loans	$	**109,821**	134,183	162,642
Allowance as a percentage of ending balance of student loans		**4.06%**	3.28%	3.34%

As of June 30, 2013, we believe the allowance for loan losses is adequate to cover the inherent losses on our non-FFEL student loan portfolio.

Delinquencies have the potential to adversely affect earnings through increased collection costs and charge-offs. The June 30, 2013, table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $10.1 million of student loans categorized as in-litigation, $10.0 million of student loans categorized as uninsured and $195 thousand of student loans with credit balances.

As of June 30, 2013 (in thousands)	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	$ 41,673		$ 385		$ 42,058	
Loans in deferment and forbearance:						
Deferment	857,876		3,616		861,492	
Forbearance	893,008		984		893,992	
Total loans in-school/in-grace, and deferment and forbearance	$ 1,792,557		$ 4,985		$ 1,797,542	
Loans in repayment:						
Current	$ 5,090,551	88.5%	$ 93,466	93.7%	$ 5,184,017	88.6%
31 – 60 days	222,325	3.9%	1,880	1.9%	224,205	3.8%
61 – 90 days	119,266	2.1%	1,003	1.0%	120,269	2.1%
91 – 120 days	75,819	1.3%	246	0.2%	76,065	1.3%
121 – 180 days	103,699	1.8%	308	0.3%	104,007	1.8%
181 – 270 days	98,687	1.7%	31	0.1%	98,718	1.7%
271 days or greater	30,376	0.5%	98	0.1%	30,474	0.5%
Claims filed not paid	11,488	0.2%	2,726	2.7%	14,214	0.2%
Total loans in repayment	$ 5,752,211	100.0%	$ 99,758	100.0%	$ 5,851,969	100.0%

The June 30, 2012, table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $10.9 million of student loans categorized as in-litigation, $10.2 million of student loans categorized as uninsured and $519 thousand of student loans with credit balances.

As of June 30, 2012 (in thousands)	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	$ 79,530		$ 1,175		$ 80,705	
Loans in deferment and forbearance:						
Deferment	913,994		4,481		918,475	
Forbearance	859,508		1,592		861,100	
Total loans in-school/in-grace, and deferment and forbearance	$ 1,853,032		$ 7,248		$ 1,860,280	
Loans in repayment:						
Current	$ 4,908,254	88.8%	$ 115,113	95.3%	$ 5,023,367	88.9%
31 – 60 days	209,713	3.8%	1,805	1.5%	211,518	3.7%
61 – 90 days	114,567	2.1%	605	0.5%	115,172	2.0%
91 – 120 days	71,199	1.3%	713	0.6%	71,912	1.3%
121 – 180 days	91,032	1.6%	273	0.2%	91,305	1.6%
181 – 270 days	88,804	1.6%	6	0.1%	88,810	1.6%
271 days or greater	31,701	0.6%	159	0.1%	31,860	0.6%
Claims filed not paid	12,478	0.2%	2,054	1.7%	14,532	0.3%
Total loans in repayment	$ 5,527,748	100.0%	$ 120,728	100.0%	$ 5,648,476	100.0%

The June 30, 2011, table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $12.2 million of student loans categorized as in-litigation, $9.6 million of student loans categorized as uninsured and $242 thousand of student loans with credit balances.

As of June 30, 2011 (in thousands)	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	$ 193,084		$ 3,103		$ 196,187	
Loans in deferment and forbearance:						
Deferment	1,177,671		4,824		1,182,495	
Forbearance	1,156,661		1,982		1,158,643	
Total loans in-school/in-grace, and deferment and forbearance	$ 2,527,416		$ 9,909		$ 2,537,325	
Loans in repayment:						
Current	$ 5,601,080	88.9%	$ 136,869	94.3%	$ 5,737,949	89.0%
31 – 60 days	248,551	3.9%	2,988	2.0%	251,539	3.9%
61 – 90 days	131,147	2.1%	1,207	0.8%	132,354	2.1%
91 – 120 days	76,665	1.1%	596	0.4%	77,261	1.2%
121 – 180 days	106,098	1.7%	413	0.3%	106,511	1.6%
181 – 270 days	94,632	1.5%	44	0.1%	94,676	1.5%
271 days or greater	29,004	0.5%	267	0.2%	29,271	0.4%
Claims filed not paid	15,776	0.3%	2,751	1.9%	18,527	0.3%
Total loans in repayment	$ 6,302,953	100.0%	$ 145,135	100.0%	$ 6,448,088	100.0%

Servicing Liability

We can incur losses on our portfolio of loans and on the portfolio of loans serviced by us for our clients (excluding the federally owned FFEL and Direct Loan program loans) by not meeting servicing regulations. We make estimates of the potential loan losses based upon our continuing evaluation of the loan portfolio, past and anticipated loss experience, current operating information, and changes in economic conditions. We record charge-offs for liabilities associated with servicing student loans for our clients.

In the following table, we report the allowance for loan losses-servicing liability within "Accounts payable and accrued expenses" within the Statements of Net Position. In the following table, we report the "provision for losses" as "servicing liability" in "Other" operating expenses in the Statements of Revenues, Expenses and Changes in Net Position.

As of June 30 (in thousands)	**2013**	2012	2011
Balance at beginning of period	$ **4,349**	3,020	2,513
Provision for losses	**1,180**	1,817	1,130
Charge-offs	**(1,813)**	(488)	(623)
Balance at end of period	$ **3,716**	4,349	3,020

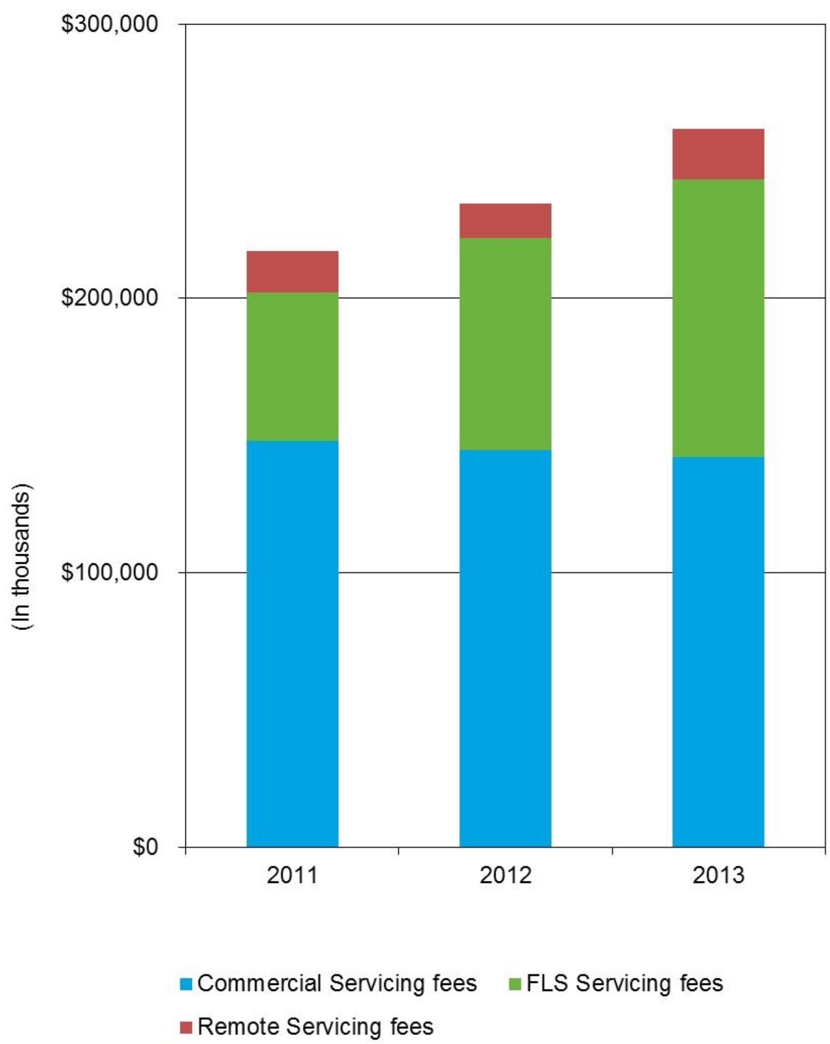
The increase in the charge-offs was due to the settling of a servicing issue identified during the year. As of June 30, 2013, we believe the allowance for loan losses-servicing liability is adequate to cover the inherent losses on our portfolio of loans and on the portfolio of loans serviced by us for our clients.

Noninterest Revenue

As of June 30 (in thousands)		2013	2012	2011
Servicing fees	$	**261,923**	234,656	217,146
Retention of collections on defaulted loans, net		**180,776**	171,117	148,842
Federal fees		**24,017**	26,253	28,347
Gain on debt retirement		**57,790**	23,315	-
Gain (loss) on student loan sales, net		**1,763**	(12,770)	(1,557)
Other		**(1,900)**	(1,484)	(1,036)
Total noninterest revenue	$	**524,369**	441,087	391,742

Servicing Fees

For the 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 financial institutions and secondary markets as "Commercial Servicing"; whereas, we categorize revenue earned from loans owned by ED as "FLS 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, 2013, total servicing fees were $261.9 million, an 11.6% increase from $234.7 million in 2012. During 2013, total servicing fees increased due to increased volume of loans serviced in our FLS and Remote servicing lines of business, which was offset by decreased servicing revenue in our Commercial Servicing line of business. For the year ended June 30, 2013, the average third party loans serviced on our systems were $195.5 billion, a 40.7% increase from $138.9 billion in 2012.

For the year ended June 30, 2012, total servicing fees were $234.7 million, an 8.1% increase from $217.1 million in 2011. During 2012, total servicing fees increased due to increased volume of loans serviced in our FLS servicing line of business, which was offset by decreased servicing revenue in our Commercial Servicing line of business. For the year ended June 30, 2012, the average third party loans serviced on our systems were $138.9 billion, a 27.8% increase from $108.7 billion in 2011.

Commercial Servicing Fees

For the year ended June 30, 2013, Commercial Servicing fees were $142.1 million, a 1.9% decrease from $144.8 million in 2012. The decrease in Commercial Servicing fees was due to a declining Commercial Servicing loan portfolio. For the year ended June 30, 2013, the average Commercial Servicing portfolio of loans was $50.7 billion, a 3.8% decrease from $52.7 billion in 2012.

For the year ended June 30, 2012, Commercial Servicing fees were $144.8 million, a 2.2% decrease from $148.1 million in 2011. The decrease in Commercial Servicing fees was due to lower fees earned on new contracts awarded for servicing during the fiscal year. This volume replaced volume on higher fee contracts previously in place where volumes continued to decrease. For the year ended June 30, 2012, the average Commercial Servicing portfolio of loans was $52.7 billion, an 11.2% increase from $47.4 billion in 2011.

FLS Servicing Fees

For the year ended June 30, 2013, FLS Servicing fees were $101.3 million, a 31.2% increase from $77.2 million in 2012. The increase in FLS Servicing fees was due to an increase in the portfolio of loans serviced by us for ED. For the year ended June 30, 2013, the average FLS servicing portfolio of loans was $103.3 billion, a 66.9% increase from $61.9 billion in 2012.

For the year ended June 30, 2012, FLS Servicing fees were $77.2 million, a 43.0% increase from $54.0 million in 2011. The increase in FLS Servicing fees was due to an increase in the portfolio of loans serviced by us for ED. For the year ended June 30, 2012, the average FLS servicing portfolio of loans was $61.9 billion, a 76.9% increase from $35.0 billion in 2011.

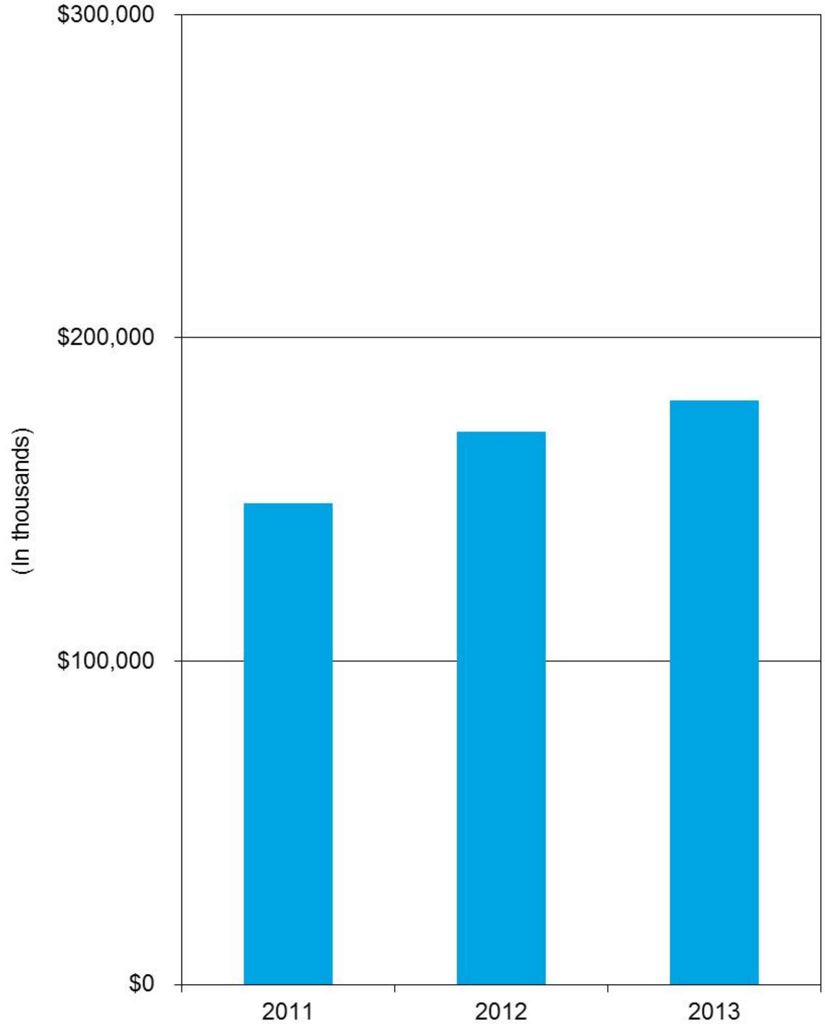
Remote Servicing Fees

For the year ended June 30, 2013, Remote Servicing fees were $18.5 million, a 45.7% increase from $12.7 million in 2012. The increase in Remote Servicing fees was mainly due to an increase in the portfolio of loans held on our system for NFP Servicers. For the year ended June 30, 2013, the average Remote Servicing portfolio of loans was $41.5 billion, a 70.8% increase from $24.3 billion in 2012. Of the $41.5 billion of the Remote Servicing portfolio of loans, $26.6 billion was related to the NFP Servicers for the year ended June 30, 2013, compared to $4.8 billion for the same period ended 2012.

For the year ended June 30, 2012, Remote Servicing fees were $12.7 million, a 15.3% decrease from $15.0 million in 2011. The decrease in Remote Servicing fees was mainly due to fewer loans held on our system for remote clients. However, during February 2012, we started to convert loans on to our system for NFP servicers that qualified to service ED Direct Loan program loans as amended under SAFRA. For the year ended June 30, 2012, the average Remote Servicing portfolio of loans was $24.3 billion, a 7.6% decrease from $26.3 billion in 2011. Of the $24.3 billion of the Remote Servicing portfolio of loans, $4.8 billion was related to the NFP Servicers for the year ended June 30, 2012.

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 reinsures the Federal Fund based upon default rates of the portfolio of guaranteed loans and the disbursement date of the loan.

After a loan defaults, we continue to try to collect on the loan and we earn revenue on the collection of defaulted loans. The federal government allows us to retain up to 16% of the borrower's payments collected as revenue and we remit the remaining amount to the federal government, after reducing the amount by the reinsurance complement. The reinsurance complement is equal to the collection amount times a percentage (calculated as 100% less the reinsurance percentage). For rehabilitation payments, we retain 18.5% of the outstanding principal balance, 100% of the collection costs (capped at 18.5% of principal and accrued interest) and 100% of accrued interest collected as revenue.

For the year ended June 30, 2013, the retention of collections on defaulted loans, net was $180.8 million, a 5.7% increase from $171.1 million in 2012. The increase in the collections on defaulted loans, net was mainly due to the increase in the collection of rehabilitation loan payments, which was offset by a decrease in the collection of direct consolidation loan payments.

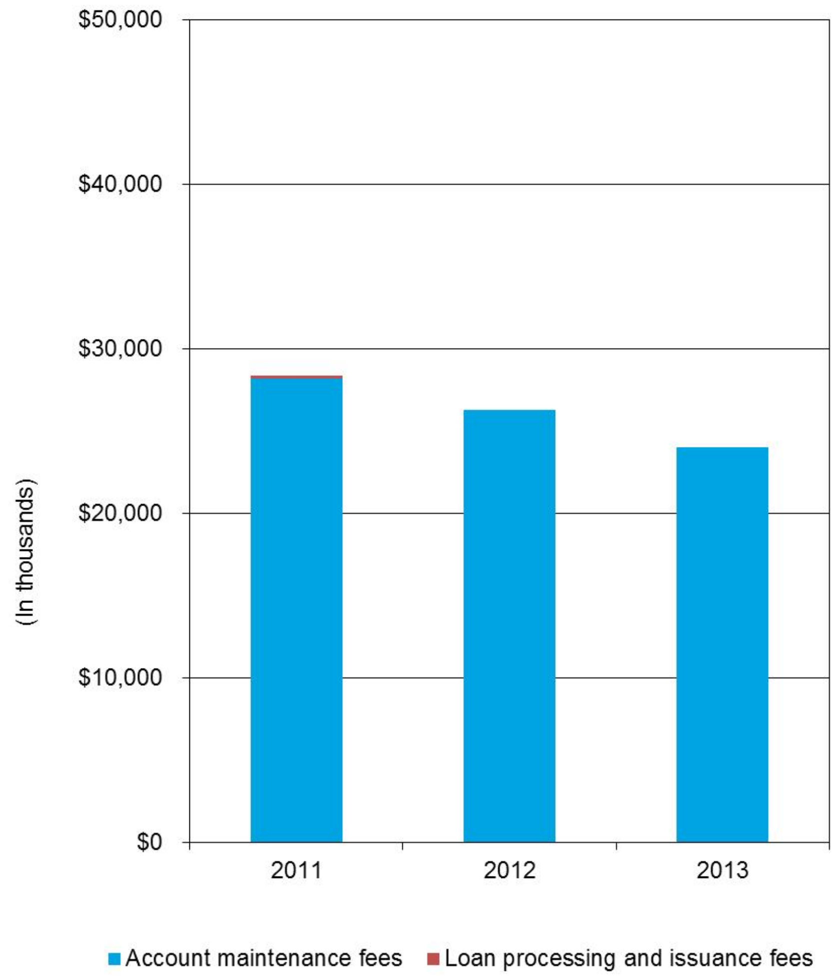
We offered discounts to eligible lenders for purchasing rehabilitation loans, and these discounts reduce the amount of collections we retain on these loans. For the year ended June 30, 2013, the discount on rehabilitation collections was $26.6 million, a 1.1% increase from $26.3 million in 2012.

For the year ended June 30, 2012, the retention of collections on defaulted loans, net, was $171.1 million, a 15.0% increase from $148.8 million in 2011. The increase in the collections on defaulted loans, net was mainly due to the increase in the collection of rehabilitation loan payments, and an increase in the collection of direct consolidation loan payments.

For the year ended June 30, 2012, the discount on rehabilitation collections was $26.3 million, a 22.9% decrease from $34.1 million in 2011.

Federal Fees

Years ended June 30

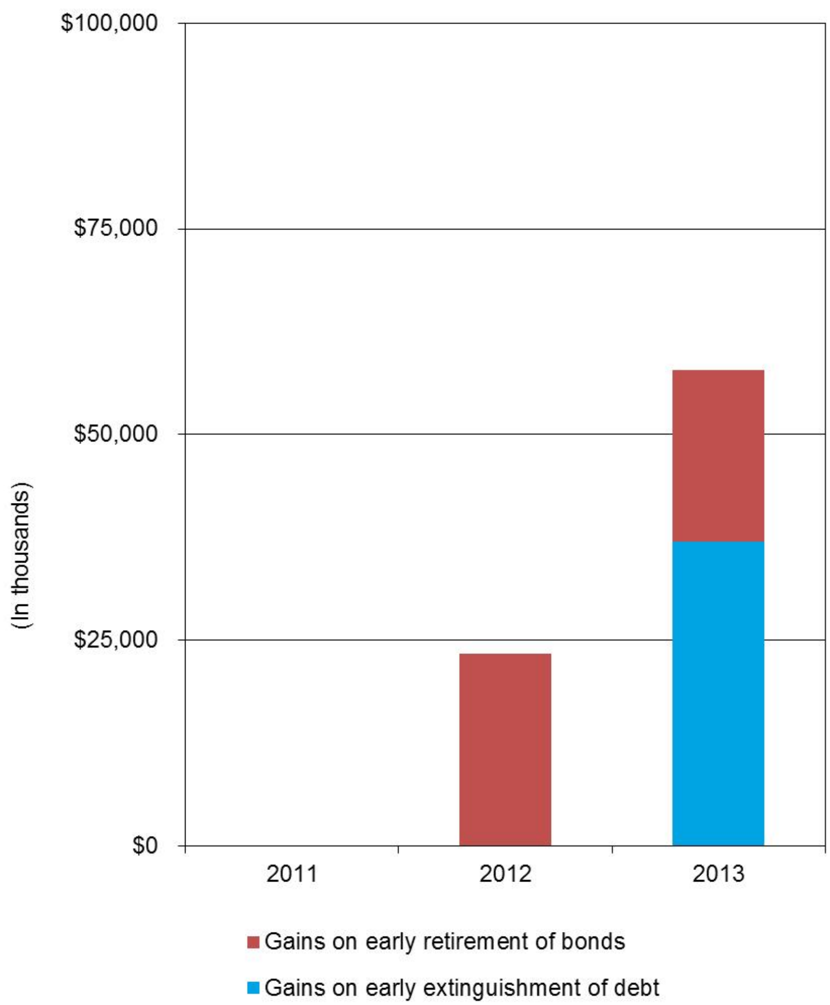


We earn account maintenance fees, which we classify as federal fees, from operating the guaranty agency. ED pays us an annual account maintenance fee that is 0.06% of the original principal amount of outstanding loans guaranteed as long as the guarantee remains in force. In the past, ED paid us a loan processing and issuance fee of 0.40% on disbursed loans, which we guaranteed. On July 1, 2010, SAFRA eliminated the loan processing and issuance fees.

For the year ended June 30, 2013, federal fees were $24.0 million, an 8.7% decrease from $26.3 million in 2012. The decrease in federal fees was mainly due to a decrease in the average original principal balance of outstanding loans guaranteed. For the year ended June 30, 2013, the average original principal balance of outstanding loans guaranteed was $39.4 billion, a 9.4% decrease from $43.5 billion in 2012.

For the year ended June 30, 2012, federal fees were $26.3 million, a 7.1% decrease from $28.3 million in 2011. The decrease in federal fees was mainly due to a decrease in the average original principal balance of outstanding loans guaranteed. For the year ended June 30, 2012, the average original principal balance of outstanding loans guaranteed was $43.5 billion, a 7.4% decrease from $47.0 billion in 2011.

Gains on Debt Retirement
Years ended June 30



For the year ended June 30, 2013, the gains on debt retirement were $57.8 million, an increase from $23.3 million in 2012.

On November 14, 2012, we extinguished $45.4 million of notes for $8.4 million, which resulted in a $37.0 million gain on the early extinguishment of debt.

For the year ended June 30, 2013, we purchased and cancelled from the 1997 Master Trust $378.5 million of par value bonds for $357.7 million, which resulted in a $20.8 million gain on the early retirement of bonds. For the year ended June 30, 2012, we purchased and cancelled from the 1997 Master Trust $259.7 million of par value bonds for $236.4 million, which resulted in a $23.3 million gain on the early retirement of bonds.

Gain (Loss) on Student Loan Sales, net

For the years ended June 30 (in thousands)		**2013**	2012	2011
Gain (loss) on student loan sales, net	$	**1,763**	(12,770)	(1,557)

For the year ended June 30, 2013, the gain on student loan sales, net was $1.8 million compared to the loss on student loan sales, net, of $12.8 million in 2012. The change was mainly due to a $10.1 million loss on student loan sales that was associated with a prior period bond refunding. As part of the bond refunding that took place on July 14, 2011, we sold $462.9 million of student loans to a financial institution for $452.8 million that resulted in a loss on sale of approximately $10.1 million.

For the year ended June 30, 2012, the loss on student loan sales, net, was $12.8 million compared to the loss on student loan sales, net, of $1.6 million in 2011. The change was due the sale of $462.9 million of student loans mentioned above.

Operating Expenses

The following table displays our major categories of operating expenses for the years ended June 30, 2013, 2012 and 2011.

For the years ended June 30 (in thousands)		**2013**			2012			2011	
Personnel and benefits	$	**176,080**	**51.7%**	$	155,892	51.4%	$	144,090	49.8%
Professional services		**57,976**	**17.0%**		55,513	18.3%		51,804	17.9%
Information technology related expenses		**31,880**	**9.4%**		29,751	9.8%		25,195	8.7%
Mail services		**30,142**	**8.9%**		27,886	9.2%		25,878	9.0%
Depreciation		**8,578**	**2.5%**		7,667	2.5%		8,542	3.0%
Other		**35,662**	**10.5%**		26,423	8.8%		33,425	11.6%
	$	**340,318**	**100.0%**	$	303,132	100.0%	$	288,934	100.0%

For the year ended June 30, 2013, operating expenses were $340.3 million, a 12.3% increase from $303.1 million in 2012. For the year ended June 30, 2012, operating expenses were $303.1 million, a 4.9% increase from $288.9 million in 2011. In the following section, we discuss changes in personnel and benefits, professional services and other.

Personnel and Benefits

The following table displays personnel and benefits expenses:

For years ended June 30 (in thousands)		**2013**			2012			2011	
Personnel and Benefits									
Compensation	$	**124,646**	**70.8%**	$	113,895	73.1%	$	107,024	74.3%
Health care benefits for employees and retirees		**24,566**	**13.9%**		22,031	14.1%		18,406	12.7%
Retirement contributions		**12,028**	**6.8%**		7,561	4.9%		4,366	3.0%
Employer's share of Social Security		**9,090**	**5.2%**		8,295	5.3%		7,905	5.5%
Independent contractor fees		**8,099**	**4.6%**		6,423	4.1%		7,572	5.3%
Capitalized software development costs		**(3,593)**	**(2.0%)**		(3,332)	(2.1%)		(2,082)	(1.4%)
Other		**1,244**	**0.7%**		1,019	0.6%		899	0.6%
	$	**176,080**	**100.0%**	$	155,892	100.0%	$	144,090	100.0%

For the year ended June 30, 2013, personnel and benefits costs were $176.1 million, a 13.0% increase from $155.9 million in 2012. For the year ended June 30, 2012, personnel and benefits costs were $155.9 million, an 8.2% increase from $144.1 million in 2011. A discussion on the changes in personnel and benefit costs follows.

Compensation

For the year ended June 30, 2013, compensation costs were $124.6 million, a 9.4% increase from $113.9 million in 2012. For the year ended June 30, 2012, compensation costs were $113.9 million, an 6.4% increase from $107.0 million in 2011. The increase in compensation costs during 2013 and 2012 was due primarily to an increase in personnel. For the year ended June 30, 2013, our average personnel headcount was 2,801, a 7.9% increase from 2,597 in 2012. For the year ended June 30, 2012, our average personnel headcount was 2,597, a 7.9% increase from 2,407 in 2011. The increase in personnel headcount during 2013 and 2012 was mainly due to increases in our FedLoan Servicing department.

Healthcare Benefits for Employees and Retirees

For the year ended June 30, 2013, healthcare benefits for employees and retirees were $24.6 million, an 11.8% increase from $22.0 million in 2012. The increase in healthcare benefits for employees and retirees during 2013 was due to an increase in personnel, as discussed above under "*Compensation*", and the increase in the employer's share of healthcare costs. For the year ended June 30, 2013, the employer's share of healthcare costs increased from $375 per employee per pay period to $390 per employee per pay period.

For the year ended June 30, 2012, healthcare benefits for employees and retirees were $22.0 million, a 19.6% increase from $18.4 million in 2011. The increase in healthcare benefits for employees and retirees during 2012 was mainly due to a change in accounting estimate resulting from changes to the employer contribution rates agreed to under the new union contract.

Retirement Contributions

For the year ended June 30, 2013, retirement contributions were $12.0 million, a 57.9% increase from $7.6 million in 2012. The increase in retirement contributions during 2013 was due to an increase in the employer's contribution rate and an increase in personnel, as discussed above under "*Compensation*". For the year ended June 30, 2013, the employer's contribution rate increased from 6.99% to 10.51% for the "AA" Class of Service employees, which was an increase of 50.4%. The majority of our employees fall under the "AA" Class of Service.

For the year ended June 30, 2012, retirement contributions were $7.6 million, a 72.7% increase from $4.4 million in 2011. The increase in retirement contributions during 2013 was due to an increase in the employer's contribution rate and an increase in personnel, as discussed above under "*Compensation*". For the year ended June 30, 2012, the employer's contribution rate increased from 4.11% to 6.99% for the "AA" Class of Service employees, which was an increase of 70.1%.

Professional Services

The following table displays professional services expenses:

For the years ended June 30 (in thousands)		**2013**			2012			2011	
Professional Services									
Collection agency fees	$	**41,592**	**71.8%**	$	41,929	75.5%	$	39,117	75.5%
Legal fees		**7,647**	**13.2%**		6,061	10.9%		5,697	11.0%
Default aversion outsourcing fees		**3,611**	**6.2%**		3,838	6.9%		3,896	7.5%
Audit fees		**1,678**	**2.9%**		1,337	2.4%		1,577	3.0%
Consulting fees		**706**	**1.2%**		825	1.5%		331	0.7%
Other professional fees		**2,742**	**4.7%**		1,523	2.8%		1,186	2.3%
	$	**57,976**	**100.0%**	$	55,513	100.0%	$	51,804	100.0%

For the year ended June 30, 2013, professional services were $58.0 million, a 4.5% increase from $55.5 million in 2012. For the year ended June 30, 2012, professional services were $55.5 million, a 7.1% increase from $51.8 million in 2011. A discussion on the changes in professional services follows.

Collection Agency Fees

For the year ended June 30, 2013, collection agency fees were $41.6 million, a 0.7% decrease from $41.9 million in 2012. The decrease in collection agency fees during 2013 was due to reduced collection volume from outside collectors.

For the year ended June 30, 2012, collection agency fees were $41.9 million, a 7.2% increase from $39.1 million in 2011. The increase in collection agency fees during 2012 was due to an increase in the collection of rehabilitation and direct consolidation loan payments. See "**Retention of Collections on Defaulted Loans, net**" for more details.

Legal Fees

For the year ended June 30, 2013, legal fees were $7.6 million, a 24.6% increase from $6.1 million in 2012. For the year ended June 30, 2012, legal fees were $6.1 million, a 7.0% increase from $5.7 million in 2011. The increase in legal fees during 2013 and 2012 was due to bond refundings that occurred during the current and prior year. These legal fees are not debt issuance costs, but rather current period costs incurred due to the creation and review of various legal documents associated with the bond refundings.

Other

The following table displays other expenses:

For the years ended June 30 (in thousands)		**2013**			2012			2011	
Other expenses									
Net realizable value adjustment in amounts due from the Federal Fund	**$**	**11,623**	**32.6%**	$	-	-	$	-	-
Buildings and grounds		**5,116**	**14.3%**		4,777	18.1%		5,362	16.0%
Telephone		**4,683**	**13.1%**		4,052	15.3%		3,516	10.5%
Bank and brokerage fees		**4,045**	**11.4%**		4,162	15.7%		4,714	14.1%
Servicing liability		**1,180**	**3.3%**		1,817	6.9%		1,130	3.4%
Legal settlements		**(48)**	**(0.1%)**		3,907	14.8%		11,578	34.7%
Other G&A		**9,063**	**25.4%**		7,708	29.2%		7,125	21.3%
	$	**35,662**	**100.0%**	$	26,423	100.0%	$	33,425	100.0%

For the year ended June 30, 2013, other expenses were $35.7 million, a 35.2% increase from $26.4 million in 2012. For the year ended June 30, 2012, other expenses were $26.4 million, a 21.0% decrease from $33.4 million in 2011. A discussion on the changes in other expenses follows.

Net Realizable Value Adjustment in Amounts Due from the Federal Fund

For the year ended June 30, 2013, the net realizable value (NRV) adjustment in amounts due from the Federal Fund was $11.6 million compared to zero in 2012. As of June 30, 2013, the total net position (total assets less accounts payable and accrued expenses) of the Federal Fund, after adding back amounts owed to PHEAA, were $78.6 million. The amounts due to PHEAA were $90.2 million, so the $11.6 million adjustment was necessary to reduce the amounts due to PHEAA to its NRV. See **Note 4 – Federal Student Loan Reserve Fund (Federal Fund) and Assets held for the U.S. Department of Education** for the details on the net position held by us for ED in the Federal Fund.

Legal Settlements

For the year ended June 30, 2013, legal settlements expense was a negative $48.0 thousand compared to $3.9 million in 2012. During the year ended June 30, 2013, legal settlements expense was reduced to a negative $48.0 thousand, because we settled a loss contingency for an amount less than we accrued for previously. During the year ended June 30, 2012, we accrued for legal settlement expenses, because of an IRS closing agreement we entered into on October 27, 2011. The IRS closing agreement required a payment of $12.3 million to the IRS, which we previously accrued $5.4 million in API liability and a $3.0 million loss contingency. During the three months period ended September 30, 2011, we accrued an additional $3.9 million loss contingency.

For the year ended June 30, 2012, legal settlements expense was $3.9 million, a 66.4% decrease from $11.6 million in 2011. The decrease in legal settlements expense was due to loss accruals recorded during the prior period related to the IRS closing agreement mentioned previously, and student loan purchase commitments.

Changes in Net Position

The following table shows the changes in net position:

For the years ended June 30 (in thousands)		2013	2012	2011
Income before grants and financial aid	$	**251,939**	192,434	150,616
Commonwealth of Pennsylvania grants		**396,784**	436,305	451,061
Federal grants		**2,435**	2,650	8,444
Grants and other financial aid, net of refunds		**(495,243)**	(510,451)	(434,305)
Grant funds returned to the Commonwealth of Pennsylvania		**(88)**	(8,352)	(944)
Grant funds returned to the federal government		**-**	-	(116)
Total grants and financial aid		**(96,112)**	(79,848)	24,140
Changes in net position	$	**155,827**	112,586	174,756

Commonwealth of Pennsylvania Grants

For the year ended June 30, 2013, Commonwealth of Pennsylvania grants were $396.8 million, a 9.1% decrease from $436.3 million in 2012. For the year ended June 30, 2012, Commonwealth of Pennsylvania grants were $436.3 million, a 3.3% decrease from $451.1 million in 2011. The decrease during 2013 and 2012 was due to the Commonwealth allocating fewer funds to the Pennsylvania State Grant program.

Grants and Other Financial Aid Activity, net of refunds

For the year ended June 30, 2013, grants and other financial aid, net of refunds were $495.2 million, a 3.0% decrease from $510.5 million in 2012. For the year ended June 30, 2012, grants and other financial aid, net of refunds were $510.5 million, a 17.5% increase from $434.3 million during 2011.

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

For the years ended June 30 (in thousands)		2013	2012	2011
Pennsylvania State Grant Program, net of refunds	$	**435,505**	450,277	361,039
Institutional Assistance Grant Program, net of refunds		**24,204**	25,134	30,118
Matching Funds Program, net of refunds		**14,165**	14,016	12,505
Pennsylvania National Guard Education Assistance Program, net of refunds		**10,427**	12,129	10,525
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds		**4,434**	-	-
Higher Education for the Disadvantaged		**2,456**	1,654	-
Pennsylvania Higher Education Foundation, net of refunds		**151**	7	7,453
Other Programs, net of refunds		**3,901**	7,234	12,665
Total grants and other financial aid, net of refunds	$	**495,243**	510,451	434,305

Pennsylvania State Grant Program, net of refunds

For the year ended June 30, 2013, the Pennsylvania State Grant Program distributed $435.5 million, a 3.3% decrease from $450.3 million in 2012. For the year ended June 30, 2012, the Pennsylvania State Grant Program distributed $450.3 million, a 24.7% increase from $361.0 million in 2011. The decrease and increase during 2013 and 2012 was mainly due to the timing of the funds disbursed from the program.

Institutional Assistance Grant Program, net of refunds

For the year ended June 30, 2013, the Institutional Assistance Grant Program was $24.2 million, a 3.6% decrease from $25.1 million in 2012. The decrease during 2013 was due to the timing of the funds disbursed from the program.

For the year ended June 30, 2012, the Institutional Assistance Grant Program was $25.1 million, a 16.6% decrease from $30.1 million in 2011. The decrease during 2012 was due to the Commonwealth reducing the funding for this program.

Debt Activity and Capital Assets

Debt Activity

For the years ended June 30 (in thousands)		**2013**	2012	2011
Current liabilities:				
Student loan financings and notes and bonds payable, net	$	**165.963**	120,000	135,800
Other financings, net		**3,635**	2,040	1,965
Other liabilities		**227,414**	225,369	208,128
Total current liabilities	$	**397,012**	347,409	345,893
Long-term liabilities:				
Student loan financings and notes and bonds payable, net	$	**7,509,561**	7,569,232	9,071,825
Other financings, net		**49,071**	102,709	125,717
Other liabilities		**17,420**	16,119	13,945
Total long-term liabilities		**7,576,052**	7,688,060	9,211,487
Total liabilities	$	**7,973,064**	8,035,469	9,557,380

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 (PHEAA) shall not exceed twenty percent (20%) of the total of loans purchased, made or guaranteed by PHEAA.

As of June 30, 2013, our outstanding debt, excluding our blended component units, amounted to $4.5 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, 2013, the outstanding debt of our blended component units was $3.0 billion, of which $2.7 billion was related to the student loan trusts (PHEAA Student Loan Trust I, PHEAA Student Loan Trust 2011-1, PHEAA Student Loan Trust 2012-1 and PHEAA Student Loan Trust 2013-1), and $319.0 million was related to the conduit (PHEAA Student Loan Company II, and III) financings.

As of June 30, 2012, our outstanding debt, excluding our blended component units, amounted to $4.8 billion. As of June 30, 2012, the outstanding debt of our blended component units was $2.8 billion, of which $1.9 billion was related to the student loan trusts (PHEAA Student Loan Trust I and PHEAA Student Loan Trust 2011-1), and $935.8 million was related to the conduit (PHEAA Student Loan Company I, II, and III) financings.

As of June 30, 2011, our outstanding debt, excluding our blended component units, amounted to $7.8 billion. The outstanding debt of our blended component units was $1.6 billion, of which $481.1 million was related to the PHEAA Student Loan Trust 1, and $1.1 billion was related to our conduit financings.

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

For the years ended June 30 (in thousands)		2013	2012	2011
Capital market activity				
Proceeds from issuing student loan floating rate notes	$	**1,120,350**	1,676,400	-
Repayment of student loan auction rate security bonds		**(1,002,406)**	(2,581,455)	(641,425)
Repayment of student loan floating rate notes		**(502,860)**	(388,255)	(244,357)
Student loan financing activity				
Proceeds from issuing student loan financings		**1,580,645**	-	-
Repayment of student loan variable rate funding notes		**(616,770)**	(191,867)	(188,842)
Repayment of student loan financings		**(572,576)**	(15,800)	(8,200)
Capital financing activity				
Repayment of capital financing		**-**	-	(61,120)
Repayment of capital lease obligations		**(73)**	(312)	(4,140)
Other financing activity				
Proceeds from issuing term and other financings		**41,949**	-	-
Repayment of term and other financings		**(93,872)**	(23,090)	(9,350)
Repayment of lines of credit		**-**	-	(26,000)

2013 Debt Activity

Capital Market Activity & Student Loan Financing Activity

The $1.1 billion increase in the capital market activity was due to the bond issuances on November 14, 2012 and June 12, 2013. The $1.5 billion decrease in the capital market activity was due the purchase and cancellation of par value bonds from the 1997 Master Trust and scheduled debt payments. The $1.6 billion increase in student loan financing activity was due to borrowing requests that we executed on February 21, 2013 and April 26, 2013, from our credit and security agreement, to purchase and cancel bonds from the 1997 Master Trust and to purchase FFEL student loans from a nonprofit corporation. The $1.2 billion decrease in student loan financing activity was due to the repayment of debt under the Straight-A Funding Short-Term Note Facility, to repay the proceeds borrowed under our credit and security agreement and scheduled debt payments.

Other Financing Activity

On November 14, 2012, we extinguished $45.4 million of notes for $8.4 million, which resulted in a $37.0 million gain on the early extinguishment of debt.

On December 15, 2012, we issued $37.2 million of Capital Acquisition Refunding Bonds, Series of 2012, at a premium for $41.9 million, and the proceeds from this issuance as well as other proceeds were used to purchase and cancel $45.6 million of the outstanding Capital Acquisition Refunding Bonds, Series of 2001.

For the year ended June 30, 2013, we had $2.8 million of scheduled debt payments.

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

2012 Debt Activity

Capital Market Activity

On July 14, 2011, we purchased and cancelled $2.3 billion of taxable and tax-exempt auction rate security bonds from the 1997 Master Trust for $2.1 billion, which resulted in a $221.1 million deferred gain on tender. On that same day, the 2011-1 Trust issued $1.7 billion of floating rate notes with an interest rate of 3-month LIBOR plus 1.10% and a final maturity date of June 25, 2038. On that same day, we sold $462.9 million of student loans to a financial institution for $452.8 million that resulted in a loss on sale of approximately $10.1 million.

For year ended June 30, 2012, we purchased and cancelled $259.7 million of senior and subordinate auction rate security bonds from the 1997 Master Trust for $234.4 million that resulted in a $25.3 million gain.

Student Loan Financings Activity

The decrease in the student loan financings activity was due to scheduled debt payments.

Other Financing Activity

The decrease in the other financing activity was due to management exercising a call option on $15.0 million of Capital Acquisition Refunding Bonds, Series 2001 on April 2, 2012, and scheduled debt payments.

Capital Assets

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

As of June 30 (in thousands)		2013	2012	2011
Land	$	**2,946**	2,946	2,946
Buildings and improvements, net		**34,586**	32,791	32,988
Software development, net		**7,397**	6,864	6,750
Purchased software, net		**4,545**	3,215	2,697
Other, principally information technology and phone equipment, net		**11,094**	9,890	8,247
	$	**60,568**	55,706	53,628

Net Position

The following table shows our net position as of June 30, and a discussion of the changes in net position follows.

As of June 30 (in thousands)		2013	2012	2011
Net investment in capital assets	$	**60,492**	55,557	53,264
Restricted for debt service		**295,895**	201,741	253,880
Restricted for financial aid grant programs		**36,647**	52,243	81,307
Unrestricted		**558,600**	486,266	294,770
	$	**951,634**	795,807	683,221

Net investment in capital assets

Capital assets include land, buildings and improvements, software development, purchased 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 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, 2013, net investment in capital assets was $60.5 million, an 8.8% increase from $55.6 million as of June 30, 2012. The increase during 2013 was mainly due to building improvements performed during the fiscal year.

As of June 30, 2012, net investment in capital assets was $55.6 million, a 4.3% increase from $53.3 million as of June 30, 2011. The increase during 2012 was mainly due to an increase in IT and phone equipment, and 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, 2013, we had net position restricted for debt service of $295.9 million, a 46.7% increase from $201.7 million as of June 30, 2012. The increase in net position restricted for debt service was due to $29.6 million of operating income restricted for debt service and $64.6 million of net transfers from unrestricted net position. See **Note 13 – Segment Information** for more details. The transfers from unrestricted net position were due to the proceeds used to redeem a funding note purchase agreement from a conduit financing, contributions to purchase a FFEL student loan portfolio from a nonprofit corporation, the exercise of a funding request in order to purchase and cancel auction rate security bonds from the 1997 Master Trust, which was offset by required distributions to PHEAA from various floating rate notes and the conduits. See **Note 8 – Notes and Bonds Payable and Other Financings** for more details.

As of June 30, 2012, we had net position restricted for debt service of $201.7 million, a 20.6% decrease from $253.9 million as of June 30, 2011. The decrease in net position restricted for debt service was due to $108.8 million of operating income restricted for debt service, which was offset by $161.0 million of transfers to unrestricted net position. The transfers to unrestricted net position were due to mandatory debt service payments on the capital acquisition refunding bonds, distributions to PHEAA from various floating rate notes and the conduits, and to the bond refunding that took place on July 14, 2011.

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, 2013, we had net position restricted for financial aid grant programs of $36.6 million, a 29.8% decrease from $52.2 million as of June 30, 2012. The decrease in net position restricted for financial aid grant programs was mainly due to $446.6 thousand of operating income restricted for financial aid grant programs, $399.3 million of net grant funding, and $75.0 million in transfers from the grant supplement fund, which was offset by $490.3 million of grant disbursements.

As of June 30, 2012, we had net position restricted for financial aid grant programs of $52.2 million, a 35.8% decrease from $81.3 million as of June 30, 2011. The decrease in net position restricted for financial aid grant programs was mainly due to $244 thousand of operating income restricted for financial aid grant programs, $430.6 million of net grant funding, $50.0 million of transfers from the grant supplement fund (unrestricted), which were offset by $509.8 million of grant disbursements.

Unrestricted

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 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, 2013, we had unrestricted net position of $558.6 million, a 14.9% increase from $486.3 million as of June 30, 2012. The increase in unrestricted net position was due to unrestricted operating income of $211.9 million, which was offset by $64.6 million of net transfers to net position restricted for debt service, $75.0 million in transfers to the Pennsylvania State Grant Program (restricted for financial aid grant programs.

As of June 30, 2012, we had unrestricted net position of $486.3 million, a 65.0% increase from $294.8 million as of June 30, 2011. The increase in unrestricted net position was due to unrestricted operating income of $130.5 million and $111.0 million of transfers from net position restricted for debt service, which were offset by a $50.0 million transfer to the State Grant Program.

Federal Student Loan Reserve Fund (Federal Fund)

As a guarantor, 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.

For the years ended June 30 (in thousands)		**2013**	2012	2011
Additions				
Reinsurance from the U.S. Department of Education	$	**1,235,105**	1,282,775	1,205,108
Collections on defaulted loans		**774,137**	729,401	680,517
Transfers of guarantee reserves		**3,535**	-	-
Net appreciation in fair value of investments		**24**	21	35
Federal default fees		**-**	(3)	378
Other		**-**	-	208
Total additions		**2,012,801**	2,012,194	1,886,246
Deductions				
Purchases of defaulted loans from lenders		**1,282,000**	1,331,242	1,249,578
Reimbursement to U.S. Department of Education for federal share of defaulted loans collections		**545,989**	512,099	479,943
Reimbursement to PHEAA for our retention of defaulted loans collections		**207,365**	197,421	182,961
Default aversion fees, net		**11,756**	15,343	20,113
Total deductions		**2,047,110**	2,056,105	1,932,595
Net decrease		**(34,309)**	(43,911)	(46,349)
Net liabilities, beginning of period		**(136,436)**	(92,525)	(46,176)
Net liabilities, end of period	$	**(170,745)**	(136,436)	(92,525)

For the years ended June 30, 2013 and 2012, purchases of defaulted loans were $1.3 billion. For the year ended June 30, 2012, purchases of defaulted loans were $1.3 billion, which was an 8.3% increase from $1.2 billion in 2011.

Under current law, we are required to manage the Federal Fund so net position is greater than 0.25% of the original principal balance of outstanding guarantees. 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.

The following table displays our calculation of the ratio on a regulatory basis of accounting. The gain contingencies included in the following table reflect 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 on the following table were agreed to in a management plan approved by ED on May 22, 2007.

(In thousands)		**As of June 30, 2013**	As of September 30, 2012
Generally accepted accounting principles – net position	$	**(170,745)**	(147,081)
Gain contingency – default aversion fee rebate payable from PHEAA to the Federal Fund		**2,981**	2,875
Gain contingency – collections complement on future default collections		**101,489**	136,554
Default aversion fees payable to PHEAA, but not transferred from the Federal Fund to PHEAA		**159,122**	148,812
Regulatory net position	$	**92,847**	141,160
Original principal outstanding	$	**38,329,414**	39,946,752
		0.24%	0.35%

The decrease in the "Gain contingency – collections complement on future default collections" was due to an adjustment to the projected amount of future cash receipts expected to be received by the Federal Fund. If the net position of the Federal Fund is less than 0.25% of the original principal balance outstanding of guarantees as of September 30, 2013 and that ratio continues to be less than 0.25% at the end of the next federal fiscal year, we will have to submit a new management plan to ED. 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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October 3, 2013

Ernst & Young LLP
621 East Pratt Street
Baltimore, MD 21202

Report of Independent Auditors

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, 2013 and 2012, 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 financial statements referred to above present fairly, in all material respects, the respective financial position of PHEAA as of June 30, 2013 and 2012, and the respective changes in financial position and, where applicable, cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Required Supplementary Information

U.S. generally accepted accounting principles require that Management's Discussion and Analysis on pages 2 through 37 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
October 3, 2013

(In thousands)

		2013	2012
Operating revenues and expenses			
Interest revenue			
Student loans	$	**138,252**	153,722
Investments		**8,615**	5,454
Total interest revenue		**146,867**	159,176
Interest expense			
Student loan financings and notes and bonds payable		**72,297**	98,304
Other financings		**1,534**	3,383
Total interest expense		**73,831**	101,687
Net interest revenue		**73,036**	57,489
Provision for loan losses		**(5,069)**	(3,086)
Net interest revenue after provision for loan losses		**67,967**	54,403
Noninterest revenue			
Servicing fees		**261,923**	234,656
Retention of collections on defaulted loans, net		**180,776**	171,117
Federal fees		**24,017**	26,253
Gain on debt retirement		**57,790**	23,315
Gain (loss) on student loans sales, net		**1,763**	(12,770)
Other		**(1,900)**	(1,484)
Total noninterest revenue		**524,369**	441,087
Operating revenues		**592,336**	495,490
Operating expenses			
Personnel and benefits		**176,080**	155,892
Professional services		**57,976**	55,513
Information technology related expenses		**31,880**	29,751
Mail services		**30,142**	27,886
Depreciation		**8,578**	7,667
Other		**35,662**	26,423
Total operating expenses		**340,318**	303,132
Operating income		**252,018**	192,358
Non-operating gains			
(Loss) gain on sale of fixed assets		**(79)**	76
Income before grants		**251,939**	192,434
Grants and financial aid			
Commonwealth of Pennsylvania grants		**396,784**	436,305
Federal grants		**2,435**	2,650
Grants and other financial aid, net of refunds		**(495,243)**	(510,451)
Grant funds returned to the Commonwealth of Pennsylvania		**(88)**	(8,352)
Total grants and financial aid		**(96,112)**	(79,848)
Changes in net position		**155,827**	112,586
Net position, beginning of period		**795,807**	683,221
Net position, end of period	$	**951,634**	795,807

See accompanying notes to financial statements.

(In thousands)

		2013	2012
Current assets:			
Cash and cash equivalents	$	**88,702**	83,072
Restricted cash and cash equivalents		**234,972**	279,309
Restricted cash and cash equivalents – due to customers		**71,672**	91,135
Investments		**413,044**	407,752
Restricted investments		**34,026**	49,214
Student loans receivable, net		**1,067,929**	928,297
Interest income receivable		**117,507**	106,685
Due from Federal Student Loan Reserve Fund, net		**78,582**	58,630
Federal Student Loan Reserve Fund assets held for U.S. Department of Education, net		**78,582**	67,111
Other assets		**55,620**	53,373
Total current assets		**2,240,636**	2,124,578
Long-term assets:			
Student loans receivable, net		**6,576,773**	6,611,508
Capital assets, net		**60,568**	55,706
Deferred financing costs		**46,721**	39,484
Total long-term assets		**6,684,062**	6,706,698
Total assets		**8,924,698**	8,831,276
Current liabilities:			
Accounts payable and accrued expenses		**148,832**	158,258
Student loan financings and notes and bonds payable		**165,963**	120,000
Amounts related to the Federal Student Loan Reserve Fund		**78,582**	67,111
Other financings, net		**3,635**	2,040
Total current liabilities		**397,012**	347,409
Long-term liabilities:			
Student loan financings and notes and bonds payable, net		**7,509,561**	7,569,232
Other financings, net		**49,071**	102,709
Accrued expenses		**17,420**	16,119
Total long-term liabilities		**7,576,052**	7,688,060
Total liabilities		**7,973,064**	8,035,469
Net position:			
Net investment in capital assets		**60,492**	55,557
Restricted for debt service		**295,895**	201,741
Restricted for financial aid grant programs		**36,647**	52,243
Unrestricted		**558,600**	486,266
Total net position	$	**951,634**	795,807

See accompanying notes to financial statements.

(In thousands)

		2013	2012
Cash flows from operating activities			
Interest received on student loans	$	**49,492**	216,938
Principal received on student loans		**1,055,752**	993,754
Student loan originations		**-**	(8)
Student loan purchases		**(1,244,042)**	(19,086)
Student loan sales, including net gains and losses		**158,628**	498,684
Servicing fees		**268,023**	227,808
Retention of collections on defaulted loans		**160,823**	140,800
Federal fees		**24,478**	26,807
Default aversion fee rebates		**(3,387)**	(3,194)
Other		**57,543**	10,874
Payment of operating expenses		**(323,512)**	(299,588)
Net cash provided by operating activities		**203,798**	1,793,789
Cash flows from noncapital financing activities			
Proceeds from the issuance of noncapital debt		**2,742,944**	1,676,400
Principal paid on noncapital debt		**(2,788,484)**	(3,200,467)
Interest paid on student loan financings and notes and bonds payable		**(90,409)**	(113,354)
Interest paid on other noncapital financings		**(2,411)**	(2,862)
Issuance costs		**(12,966)**	(11,695)
Commonwealth of Pennsylvania grants received		**396,784**	436,305
Federal grants received		**2,435**	2,650
Grants and financial aid paid		**(495,243)**	(510,451)
Grant funds returned to the Commonwealth of Pennsylvania		**(88)**	(8,352)
Net cash used for noncapital financing activities		**(247,438)**	(1,731,826)
Cash flows from capital and related financing activities			
Principal paid on capital lease obligations		**(73)**	(312)
Purchases of capital assets and development of software, net of disposals		**(13,519)**	(9,669)
Net cash used for capital and related financing activities		**(13,592)**	(9,981)
Cash flows from investing activities			
Proceeds from sales and maturities of investments		**1,524,228**	1,359,404
Purchases of investments		**(1,509,508)**	(1,403,883)
Interest received on investments		**3,805**	4,313
Net cash provided by (used for) investing activities		**18,525**	(40,166)
Net change in cash and cash equivalents (including restricted cash)		**(38,707)**	11,816
Cash and cash equivalents (including restricted cash), beginning of period		**362,381**	350,565
Cash and cash equivalents (including restricted cash), end of period	$	**323,674**	362,381

(continued)

(In thousands)

		2013	2012
Reconciliation of operating income to net cash provided by operating activities			
Operating income	$	**252,018**	192,358
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation		**8,578**	7,667
Student loan financings and notes and bonds payable interest		**90,409**	113,354
Other financings interest		**2,411**	2,862
Investment interest		**(8,615)**	(5,454)
Amortization of premium on loan purchases		**16,979**	25,863
Amortization of loan origination costs		**(917)**	(1,830)
Amortization of deferred financing costs		**5,729**	9,690
Amortization of deferred gain on bond refunding		**(20,092)**	(17,417)
Amortization of deferred premium		**(350)**	-
Accretion discount on capital and other financings		**231**	156
Changes in assets and liabilities:			
(Increase) decrease in interest income receivable		**(11,561)**	27,591
(Increase) decrease in student loans receivable		**(120,959)**	1,488,211
Increase in amounts due from Federal Student Loan Reserve Fund		**(19,952)**	(30,317)
Increase in other assets		**(1,523)**	(9,093)
Increase (decrease) in accounts payable and accrued expenses		**11,412**	(9,852)
Total adjustments		**(48,220)**	1,601,431
Net cash provided by operating activities	$	**203,798**	1,793,789

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 Combined Annual Financial Report (CAFR). We are a discretely presented component unit of the Commonwealth due to the nature and significance of our relationship with the Commonwealth. The exclusion of this relationship would cause their financial statements to be misleading.

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 Trust I

On January 15, 2003, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust I (the Trust), a statutory trust. The Trust was formed under the laws of the State of Delaware and its principal purpose is 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 Trust 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.

We determined that the Trust should be treated as a component unit in order to keep our financial reports from being misleading due to the material relationship of the Trust with the Foundation. In addition, the Trust is a blended component unit of the Foundation, because the Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Company, LLC

We formed the PHEAA Student Loan Company, LLC (PHEAA SLC) on May 22, 2009, in the State of Delaware for the purpose of purchasing, acquiring, owning, holding, selling, assigning, pledging and dealing in education loans to students and parents of dependent students under the FFEL program; and issuing and selling one or more series of bonds, notes or other indebtedness secured by student loans. We created the PHEAA SLC in order to participate in the Loan Purchase Commitment Program with ED. PHEAA SLC is considered a component unit of the Foundation, because the Foundation appointed PHEAA SLC's governing body and the Foundation can impose its will on

PHEAA SLC. In addition, the PHEAA SLC is a blended component unit, because PHEAA SLC provides services entirely to the Foundation. As a blended component unit of the Foundation, the financial results of PHEAA SLC are consolidated with the financial results of the Foundation. On November 14, 2012, we repaid our outstanding debt obligation under the Straight-A Funding Short-Term Note Facility (Straight-A Program). Following the release of the related lien under the Straight-A Program, we sold the related student loans to the Foundation for subsequent sale to the PHEAA Student Loan Trust 2012-1.

PHEAA Student Loan Company II, LLC

We formed the PHEAA Student Loan Company II, LLC (PHEAA SLC II) on November 2, 2009, in the State of Delaware for the purpose of purchasing, acquiring, owning, holding, selling, assigning, pledging and dealing in education loans to students and parents of dependent students under the FFEL program; and issuing and selling one or more series of bonds, notes or other indebtedness secured by student loans. We created the PHEAA SLC II in order to participate in the Loan Purchase Commitment Program with ED. PHEAA SLC II is considered a component unit of the Foundation, because the Foundation appointed PHEAA SLC II's governing body and the Foundation can impose its will on PHEAA SLC II. In addition, PHEAA SLC II is a blended component unit, because PHEAA SLC II provides services entirely to the Foundation. As a blended component unit of the Foundation, the financial results of PHEAA SLC II are consolidated with the financial results of the Foundation.

PHEAA Student Loan Company III, LLC

We formed the PHEAA Student Loan Company III, LLC (PHEAA SLC III) on November 2, 2009, in the State of Delaware for the purpose of purchasing, acquiring, owning, holding, selling, assigning, pledging and dealing in education loans to students and parents of dependent students under the FFEL program; and issuing and selling one or more series of bonds, notes or other indebtedness secured by student loans. We created the PHEAA SLC III in order to participate in the Loan Purchase Commitment Program with ED. PHEAA SLC III is considered a component unit of the Foundation, because the Foundation appointed PHEAA SLC III's governing body and the Foundation can impose its will on PHEAA SLC III. In addition, PHEAA SLC III is a blended component unit, because PHEAA SLC III provides services entirely to the Foundation. As a blended component unit of the Foundation, the financial results of PHEAA SLC III are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2011-1

On April 7, 2011, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2011-1 (2011-1 Trust), a statutory trust. The 2011-1 Trust was formed under the laws of the State of Delaware and its principal purpose is 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 2011-1 Trust 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. The 2011-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2011-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2011-1 Trust with the Foundation. In addition, the 2011-1 Trust is a blended component unit of the Foundation, because the 2011-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2011-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2012-1

On October 11, 2012, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2012-1 (2012-1 Trust), a statutory trust. The 2012-1 Trust was formed under the laws of the State of Delaware and its principal purpose is 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 2012-1 Trust 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. The 2012-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2012-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2012-1 Trust with the Foundation. In addition, the 2012-1 Trust is a blended component unit of the Foundation, because the 2012-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2012-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2013-1

On March 18, 2013, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2013-1 (2013-1 Trust), a statutory trust. The 2013-1 Trust was formed under the laws of the State of Delaware and its principal purpose is 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 2013-1 Trust 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. The 2013-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2013-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2013-1 Trust with the Foundation. In addition, the 2013-1 Trust is a blended component unit of the Foundation, because the 2013-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2013-1 Trust are consolidated with the financial results of the Foundation.

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.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Accounting

We prepare our financial statements based on the governmental enterprise fund concept, which pertains to financial activities that operate similarly to a private business enterprise. We follow the economic resources measurement focus and accrual basis of accounting. We record revenues when earned and expenses at the time liabilities are incurred, regardless of when the related cash flows take place. While private business enterprises follow the accounting guidance issued by the Financial Accounting Standards Board (FASB), we follow the guidance issued by the Governmental Accounting Standards Board (GASB).

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that influence the reported assets, liabilities, revenues, and expenses during the reporting periods. Actual results could differ significantly from those estimates.

Cash Equivalents

Cash equivalents include investments in money market funds, U.S. government agency funds, and commercial paper with original maturities at acquisition of three months or less, and we report them at fair value.

Cash equivalents also include amounts invested in nonparticipating interest-earning investment contracts that provide a guaranteed return on principal over a specified time. These amounts include investments of bond proceeds that are used to purchase student loans and we report them using a cost-based measure. We report these amounts as cash equivalents, because we may deposit and withdraw cash at any time without prior notice or penalty.

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 invested in the Commonwealth of Pennsylvania Treasury Department (Pools 99 and 198) and other investments outside of the Treasury Department, such as money market investments, U.S. Government Agency investments and commercial paper investments.

The Treasury Department monitors and safeguards virtually all Commonwealth agency funds, which requires the Treasury Department to collect interest and dividends, execute securities transactions and handle daily trade settlements. We report the amounts invested with the Treasury Department at fair value and net asset value based upon information provided by the Treasury Department.

The amounts invested outside of the Treasury Department are reported at fair value based on the information provided by the external financial institutions.

Student Loans Receivable, net

We report student loans in the Statements of Net Position at their unpaid principal balances net an allowance for inherent losses within our student loan portfolio. We defer costs related to loan originations and premiums related to loan purchases and we recognize these costs over the life of the loan, after giving effect to estimated prepayments, as an adjustment of yield. We report the deferred amount as part of the principal balance of student loans.

Allowances for potential losses on our student loans can result from deficient servicing, risk sharing on defaults 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. 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.

We capitalize purchased 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 the asset by 25% of the original cost or life as a betterment and we record it as an addition of value to the existing asset. We calculate depreciation based on the straight-line method over the estimated useful life of the purchased software.

Software development 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 capitalize upgrades and enhancements, as defined above. We report software development at cost net of amortization. We calculate amortization based on the straight-line method over the estimated useful life of the software developed.

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) 3 – 5 years

Deferred Financing Costs

Deferred financing costs consist of underwriting and other costs of issuing financings. We amortize these costs over the term of the financing using the straight-line or effective interest method and these costs are included in interest expense.

Deferred Gain 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 deferred and amortized as a component of “Student loan financings and notes and bonds payable” 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 upon retirement or termination under these arrangements.

Revenue Recognition

Student loan income

We recognize student loan income as it is earned including adjustments for the amortization of costs of loan originations and purchases. The U.S. Secretary of Education provides a special allowance to student loan owners participating in the FFEL program on loans first disbursed prior to June 30, 2010. The special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of the 3-month financial commercial paper rate or the 1-month LIBOR, to the average daily unpaid principal balance and capitalized interest of student loans held by us. We accrue the special allowance as earned or payable. For loans first disbursed prior to January 1, 2000, the 91-day Treasury Bill rate is used rather than the 3-month financial commercial paper rate or the 1-month LIBOR.

We accrue interest on student loans based upon the actual principal amount outstanding. The U.S. Secretary of Education makes quarterly interest payments on subsidized loans until the student is required, under the provisions of the Higher Education Act of 1965, as amended, to begin repayment. Repayment must begin generally within six months after the student completes his or her course of study, leaves school, or ceases to carry at least one-half the normal full time academic load as determined by the participating institution.

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. 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 the Department of Education (ED) as “FLS Servicing”. Our Remote Servicing line of business provides our system to guarantors and other servicers to use, as well as to Not for Profit (NFP) servicers who were awarded servicing contracts by ED.

Retention of Collections on Defaulted Loans

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.

After a loan defaults, we continue to try to collect on the loan and we earn revenue on the collection of defaulted loans. The federal government allows us to retain up to 16% of the borrower’s payments collected as revenue and we remit the remaining amount, after reducing the amount by reinsurance complement, to the federal government. The reinsurance complement is maintained in the Federal Fund. For rehabilitation payments, we retain 18.5% of the original principal balance, 100% of the collection costs (capped at 18.5% of principal and accrued interest) and 100% of accrued interest collected as revenue.

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.

Advertising

We incur advertising expenses to make sure Pennsylvanians are aware of postsecondary education opportunities and default prevention initiatives. As we incur advertising expenses, we expense them.

Non-Operating Gains and (Losses)

Non-operating gains and (losses) consist of gains and losses from the sale of fixed assets.

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 Foundation, PHEAA SLC, PHEAA SLC II, PHEAA SLC III, Trust I, 2011-1 Trust, 2012-1 Trust and 2013-1 Trust are blended component units of the Foundation, and the Foundation 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.

Reclassifications

Certain prior year amounts have been reclassified to conform to current Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows.

Note 3 – New Accounting Pronouncements

During 2011, the GASB issued Statement No. 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this Statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources. GASB Concepts Statement No. 4 - *Elements of Financial Statements* introduced and defined deferred outflows and inflows of resources. Previous financial reporting standards did not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. This Statement amends the net asset reporting requirements in GASB Statement No. 34 - *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows and inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. This Statement is effective for reporting periods beginning after December 15, 2011. On July 1, 2012, management adopted this Statement, which had an immaterial impact on our financial statements.

During 2012, the GASB issued Statement No. 65 – *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. Some of these items previously reported as assets and liabilities were deferred gains on debt refundings, debt issuance costs, loan origination fees and costs, and commitment fees. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement No. 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the Board in authoritative pronouncements that are established after applicable due process. Prior to the issuance of this Statement, only two such pronouncements were issued and effective. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the changes in fair value of hedging derivative instruments, and Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, requires a deferred inflow of resources to be reported by a transferor government in a qualifying service concession arrangement. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement No. 4. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. This Statement is effective for reporting periods beginning after December 15, 2012. Currently, we are evaluating the impact of this Statement on our financial statements.

During 2012, the GASB issued Statement No. 67 – *Financial Reporting for Pension Plans an amendment of GASB Statement No. 25*. This Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement replaces the requirements of Statements No. 25 – *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50 – *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements that meet certain criteria. This Statement is effective for financial statements for fiscal years beginning after June 15, 2013 and earlier application is encouraged. This Statement does not have an impact on our financial statements, but this Statement establishes a definition of a pension plan that is described in GASB 68 below.

During 2012, the GASB issued Statement No. 68 – *Accounting and Financial Reporting for Pensions*. This Statement replaces the requirements of GASB Statement No. 27 – *Accounting for Pensions by State and Local Governmental Employers*, as they relate to pensions that are provided through pension plans administed as trusts or equivalent arrangements that meet certain criteria. This Statement and Statement No. 67 mentioned above establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement - determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. This Statement is effective for fiscal years beginning after June 15, 2014, and earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements.

During 2013, the GASB issued Statement No. 70 - *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units. This Statement is effective for reporting periods beginning after June 15, 2013. Currently, we are evaluating the impact of this Statement on our financial statements.

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.

As of June 30 (in thousands)		**2013**	2012
Assets			
Cash	$	**70,975**	1,355
Receivable from the U.S. Department of Education		**5,000**	68,241
Other receivables		**4,308**	515
Total assets		**80,283**	70,111
Liabilities			
Accounts payable and accrued expenses		**1,701**	3,000
Amounts payable to PHEAA		**249,327**	203,547
Total liabilities		**251,028**	206,547
Net liabilities	$	**(170,745)**	(136,436)

Under the Higher Education Amendments of 1998, we are to act as a fiduciary in managing the assets of the Federal Fund.

Under current law, we are required to manage the Federal Fund so net position is greater than 0.25% of the original principal balance of outstanding guarantees. 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, 2013, we have managed the cash flow of the Federal Fund in a manner to assure our customers that sufficient funds are available to continue to pay default claims by not transferring default aversion fees that are due to us. In addition to paying default claims, we pay our share of retention on defaulted loan collections from the Federal Fund.

As of June 30, 2013, we reported in the Statements of Net Position $78.6 million in the line item “Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net”, which is sum of the Federal Fund’s total assets less accounts payable and accrued expenses.

Note 5 – Cash and Investments

The following table shows the carrying value of cash and cash equivalents (unrestricted and restricted), investments (unrestricted and restricted), and cash on deposit as of June 30, 2013 and 2012.

As of June 30 (in thousands)		2013	2012
Cash and cash equivalents	$	**88,702**	83,072
Restricted cash and cash equivalents		**234,972**	279,309
Restricted cash and cash equivalents – due to customers		**71,672**	91,135
Investments		**413,044**	407,752
Restricted investments		**34,026**	49,214
Carrying value	$	**842,416**	910,482

The following table shows the fair value and maturities of our cash equivalents and investments as of June 30, 2013 and 2012.

			Maturities (in years)		
As of June 30, 2013 (in thousands)		Fair Value	Less than 1	1 to 10	More than 10
Cash equivalents					
Money market funds	$	**256,775**	**256,775**	-	-
Commercial paper		**67,717**	**67,717**	-	-
	$	**324,492**	**324,492**	-	-
Investments					
State Treasury investment pool	$	**437,079**	**437,079**	-	-
Ultra short-term bond fund		**147**	-	**147**	-
		437,226	**437,079**	**147**	-
Total cash equivalents and investments	$	**761,718**	**761,571**	**147**	-

			Maturities (in years)		
As of June 30, 2012 (in thousands)		Fair Value	Less than 1	1 to 10	More than 10
Cash equivalents					
Money market funds	$	316,247	316,247	-	-
Commercial paper		66,436	66,436	-	-
	$	382,683	382,683	-	-
Investments					
State Treasury investment pool	$	454,154	454,154	-	-
Ultra short-term bond fund		299	-	299	-
		454,453	454,154	299	-
Total cash equivalents and investments	$	837,136	836,837	299	-

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 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.

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 described above.

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.

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 separate pools, Pools 99 and 198, 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.

Pool 99 is a liquid vehicle that invests exclusively in fixed income securities, primarily of short duration. Pool 99 is organized similarly to a money market fund, with an expectation of a stable net asset value of $1 per share. The value of a share in Pool 99 is calculated daily, incorporating all realized and unrealized gains and losses, and any cash returned from investments. Pool 99’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. All gains and losses are distributed to participants monthly to re-set the value to $1 per share. Pool 99’s performance is benchmarked to the yield on the Merill Lynch three-month U.S. Treasury Bill Index. As of June 30, 2013, our investment in Pool 99 was $322.5 million compared to $346.7 million as of June 30, 2012.

Pool 198 is a variable net asset value per share investment vehicle, which uses longer-term fixed income, alternative investments and equity securities to generate enhanced investment returns over time. The funds in Pool 198 are intended to weather short-term ups and downs in the market in the interest of long-term capital appreciation. Pool 198 operates much like a mutual fund: depending on the market conditions, an account owner who makes a withdrawal may realize a gain or a loss. Shares in Pool 198 are priced at the most recent net asset value per share, which fluctuates daily. As of June 30, 2013, our investment in Pool 198 was $114.6 million compared to $107.5 million as of June 30, 2012.

For more information on Pools 99 and 198, see the Pennsylvania Treasury annual investing report for fiscal year ending June 30, 2012 (latest available) , which can be found at www.patreasury.gov/commonweathInvestments Reports.html.

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

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.

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, 2013, all of our investments in commercial paper were rated A-1 and higher. As of June 30, 2013, all of our investments in money market funds were rated AAAm. As of June 30, 2013, we have $146.8 thousand invested in an ultra-short bond fund that was rated by Moody's. Moody's provided various ratings to the ultra-short bond fund, because of the various sectors the bond fund is invested. As of June 30, 2013, 62.4% of the ultra-short bond fund was rated Aaa; 7.0% was rated Aa; 16.4% was rated A; 10.2% of the bond fund was rated Baa; and 3.9% of the bond fund was not rated . As of June 30, 2013, $437.1 million was invested in the State Treasury investment pool, and the investment pool was not rated.

As of June 30, 2012, all of our investments in commercial paper were rated A-1 and higher. As of June 30, 2012, $55.0 million of our investments in money market funds were rated AAAm and $261.2 million were rated Aaa. As of June 30, 2012, we have $299.0 thousand invested in an ultra-short bond fund that was rated by Moody's. As of June 30, 2012, 78.6% of the ultra-short bond fund was rated Aaa; 4.5% was rated Aa; 11.1% was rated A; 3.3% of the bond fund was rated Baa; and 2.7% of the bond fund was not rated. As of June 30, 2012, $454.2 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, 2013, we had $$63.0 million of cash deposits with financial institutions of which $62.8 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, 2013, we did not have investments in any one issuer that represented 5% or more of our total investments.

Note 6 – Student Loans Receivable, net

The following table shows our student loan holdings.

As of June 30 (in thousands)		2013	2012
FFEL:			
Consolidation	$	**6,049,068**	5,692,461
Stafford		**1,337,929**	1,492,350
PLUS		**163,219**	200,431
Supplemental Loans for Students		**819**	944
		7,551,035	7,386,186
HEAL		**66,965**	86,761
Uninsured loans		**42,856**	47,422
Unamortized loan origination costs		**3,572**	8,086
Unamortized (discount) or premium on loan purchases		**(2,642)**	27,520
		7,661,786	7,555,975
Allowance for loan losses		**(17,084)**	(16,170)
Student loans receivable, net	$	**7,644,702**	7,539,805

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.

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 reinsurance rate. In the following table, 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.

As of June 30 (In thousands)		2013	2012
Balance at beginning of period	$	**16,170**	16,729
Provision for losses – FFEL program loans		**5,035**	4,194
Provision for losses – other program loans (Non-FFEL)		**34**	(1,108)
Charge-offs		**(4,155)**	(3,645)
Balance at end of period	$	**17,084**	16,170

Note 7 – Capital Assets, net

We present an analysis of the capital asset activity as of and for the years ended June 30, 2013 and 2012 below:

As of and for the year ended June 30, 2013 (in thousands)		**Beginning Balance**	**Additions**	**Retirements**	**Ending Balance**
Land	$	**2,946**	**-**	**-**	**2,946**
Buildings and improvements		**68,356**	**3,568**	**-**	**71,924**
Software development		**15,188**	**3,593**	**(3,305)**	**15,476**
Purchased software		**12,011**	**2,418**	**(1,117)**	**13,312**
Other, principally information technology equipment		**27,209**	**4,047**	**(3,454)**	**27,802**
		125,710	**13,626**	**(7,876)**	**131,460**
Less accumulated depreciation for:					
Buildings and improvements		**(35,565)**	**(1,773)**	**-**	**(37,338)**
Software development		**(8,324)**	**(3,060)**	**3,305**	**(8,079)**
Purchased software		**(8,796)**	**(1,019)**	**1,048**	**(8,767)**
Other, principally information technology equipment		**(17,319)**	**(2,723)**	**3,334**	**(16,708)**
		(70,004)	**(8,575)**	**7,687**	**(70,892)**
	$	**55,706**	**5,051**	**(189)**	**60,568**

As of and for the year ended June 30, 2012 (in thousands)		**Beginning Balance**	**Additions**	**Retirements**	**Ending Balance**
Land	$	2,946	-	-	2,946
Buildings and improvements		66,933	1,482	(59)	68,356
Software development		15,994	3,332	(4,138)	15,188
Purchased software		18,763	1,110	(7,862)	12,011
Other, principally information technology equipment		36,838	3,915	(13,544)	27,209
		141,474	9,839	(25,603)	125,710
Less accumulated depreciation for:					
Buildings and improvements		(33,945)	(1,649)	29	(35,565)
Software development		(9,244)	(3,218)	4,138	(8,324)
Purchased software		(16,066)	(592)	7,862	(8,796)
Other, principally information technology equipment		(28,591)	(2,213)	13,485	(17,319)
		(87,846)	(7,672)	25,514	(70,004)
	$	53,628	2,167	(89)	55,706

Depreciation expense for the years ended June 30, 2013 and 2012 was $8.6 million and $7.7 million, respectively.

Note 8 – Notes and Bonds Payable and Other Financings

Activity for notes and bonds payable and other financings as of and for the year ended June 30, 2013, was as follows:

As of and for the year ended June 30, 2013 (in thousands)	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Student loan auction rate bonds, floating rate notes, variable rate notes and financings:					
Student loan auction rate security bonds, due 2037 - 2047, at weighted-average rates of 1.07% as of June 30, 2013 and 0.44% as of June 30, 2012.	$ 3,550,275	-	(1,033,575)	2,516,700	-
Student loan floating rate notes, due 2018 - 2038, at weighted-average rates of 0.92% as of June 30, 2013 and 0.38% as of June 30, 2012.	2,889,748	1,120,350	(502,860)	3,507,238	-
Deferred gain on bond refunding of student loan floating rate notes.	195,944	31,170	(21,677)	205,437	-
Student loan variable rate funding notes, due 2013, at an estimated weighted-average rate of 0.74% as of June 30, 2013 and 0.78% as of June 30, 2012.	935,776	-	(616,770)	319,006	4,663
Deferred loss on bond refundings of student loan variable floating rate notes	(2,511)	-	1,585	(926)	-
Student loan financings, due on demand, at weighted-average rates of 0.94% as of June 30, 2013 and 0.97% as of June 30, 2012.	120,000	49,800	(8,500)	161,300	161,300
Student loan financing warehouse facility, due 2014, at an interest rate of 0.21% as of June 30, 2013.	-	1,530,845	(564,076)	966,769	-
Deferred gain on bond refunding of student loan financing warehouse facility.	-	31,170	(31,170)	-	-
	$ 7,689,232	2,763,335	(2,777,043)	7,675,524	165,963

As of and for the year ended June 30, 2013 (in thousands)		Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Other financings:						
Term financings, due 2029, at zero percent interest as of June 30, 2013 and 2012.	$	59,334	-	(48,227)	11,107	-
Capital acquisition refunding bonds, Series 2001, due 2012 – 2030.		45,645	-	(45,645)	-	-
Unamortized discount on capital acquisition refunding bonds		(230)	-	230	-	-
Capital acquisition refunding bonds, Series of 2012, due 2013 – 2022, at weighted- average rates of 3.68% as of June 30, 2013.		-	37,235	-	37,235	3,635
Unamortized premium on capital acquisition refunding bonds		-	4,714	(350)	4,364	-
		104,749	41,949	(93,992)	52,706	3,635
	$	7,793,981	2,805,284	(2,871,035)	7,728,230	169,598

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 auction rate notes, floating and variable rate notes, and financings. As of June 30, 2013, $7.7 billion of student loan principal and related interest receivable and $229.6 million of cash equivalents collateralized the $7.7 billion of student loan financings and notes and bonds payable.

The student loan auction rate security bonds, floating rate notes, variable rate funding notes and other term financings are non-recourse obligations to our unrestricted net position and to the Commonwealth, except for the $161.3 million of student loan financings and $37.2 million of Capital Acquisition Refunding Bonds, Series of 2012, as of June 30, 2013, which are recourse obligations to us.

Student loan auction rate bonds, floating rate notes, variable rate notes and financings

For the year ended June 30, 2013, the student loan auction rate bonds, floating rate notes, variable rate notes and financings had a net decrease of $12.1 million. The change in the student loan auction rate bonds, floating rate notes, variable rate notes and financings was mainly due to the bond refundings that took place on November 14, 2012 and June 12, 2013; borrowing requests we executed through a credit and security agreement with a financial institution, so we could purchase and cancel auction rate security bonds from our 1997 Master Trust; and our scheduled debt payments.

On October 11, 2012, the Foundation entered into a trust agreement creating the PHEAA Student Loan Trust 2012-1 (2012-1 Trust) as a statutory trust under the Delaware Statutory Trust Act, 12 *Del. C.* Section 3801. On November 14, 2012, the 2012-1 Trust entered into a trust indenture and issued $536.4 million of student loan asset backed floating rate notes with an interest rate of 1-month LIBOR plus 0.55% and a final maturity date of May 25, 2027. The proceeds from the sale of these notes, together with a $14.9 million capital contribution received indirectly through the Foundation from PHEAA, were used to purchase $542.4 million (principal and interest) of student loans, pay related costs of issuance and to fund initial deposits to various funds created under the indenture, including an acquisition fund, a reserve fund and a capitalized interest fund.

On that same day, the PHEAA SLC transferred $479.4 million of proceeds from the above loan sale to repay its outstanding debt under the Straight-A Funding Short-Term Note Facility (Straight-A Program), which this debt is classified in the table on page 57 as “student loan variable rate funding notes”. Following the release of the related lien under the Straight-A Program, we sold $483.5 million (principal and interest) of student loans to the Foundation for subsequent sale to the 2012-1 Trust. On that same day, we purchased $59.5 million of student loans (principal and interest) from a financial institution for $58.0 million. Of the $59.5 million of student loans purchased from the financial institution, we sold $58.9 million of student loans to the Foundation for subsequent sale to the 2012-1 Trust.

On February 12, 2013, we entered into a Credit and Security Agreement with a financial institution and on February 21, 2013, we executed a borrowing request for $419.7 million. On March 7, 2013, the proceeds from the borrowing request were used to purchase and cancel $442.7 million of par value bonds from the 1997 Master Trust for $415.3 million, which resulted in a $27.4 million deferred gain on the purchase of debt. On April 26, 2013, we executed a second borrowing request through our credit and security agreement with a financial institution for $143.9 million. On May 9, 2013, we used the proceeds from the borrowing request to purchase and cancel $146.0 million of par value bonds from the 1997 Master Trust for $142.2 million, which resulted in a $3.8 million deferred gain on bond refunding.

On March 18, 2013, the Foundation entered into a trust agreement creating the PHEAA Student Loan Trust 2013-1 as a statutory trust under the Delaware Statutory Trust Act, 12 *Del. C*. Section 3801. On June 12, 2013, the PHEAA Student Loan Trust 2013-1 issued $584.0 million of floating rate notes with an interest rate of 1-month LIBOR plus 0.50% with a final maturity date of November 25, 2036. On that same day, we used the proceeds from the bond issuance to repay our obligations under the executed borrowing requests mentioned above.

On June 21, 2013, we executed a borrowing request through our credit and security agreement with a financial institution for $967.1 million. On June 27, 2013, we used $954.5 million of the proceeds from the borrowing request and contributed $68.1 million of our own funds to purchase $1.0 billion (principal) of FFEL student loans from a nonprofit corporation.

For the year ended June 30, 2013, we purchased and cancelled $378.5 million of par value bonds from the 1997 Master Trust for $357.7 million that resulted in a $20.8 million gain on the early retirement of bonds. The $20.8 million gain was classified in the “Statements of Revenues, Expenses and Changes in Net Position” as “Gain on Debt Retirement”.

For the year ended June 30, 2013, we had $502.9 million of scheduled debt payments.

Subsequent Event

On April 8, 2013, the Foundation entered into a trust agreement creating the PHEAA Warehouse Facility Trust 2013-1 as a statutory trust under the Delaware Statutory Trust Act, 12 *Del. C*. Section 3801. The principal purpose of the PHEAA Warehouse Facility Trust 2013-1 is to securitize student loans and student loan related assets and to acquire student loans from the Foundation and issue a note secured by a pledge of assets.

On July 12, 2013, the PHEAA Warehouse Facility Trust 2013-1 executed a borrowing request with a financial institution for $36.8 million. On July 12, 2013, PHEAA sold $38.7 million of student loans to the Foundation for subsequent sale to the PHEAA Warehouse Facility Trust 2013-1. The proceeds from the sale of student loans to the Foundation were used to purchase and cancel $40.6 million of par value bonds from the 1997 Master Trust for $39.2 million.

On September 6, 2013, the PHEAA Warehouse Facility Trust 2013-1 executed a second borrowing request with a financial institution for $343.9 million. On that same day, a portion of the proceeds from the second executed borrowing request were used to purchase and cancel $127.9 million of par value bonds from the 1997 Master Trust for $125.8 million. On September 10, 2013, the remaining proceeds from the second executed borrowing request were used to purchase and cancel $234.4 million of par value bonds from the 1997 Master Trust for $230.8 million.

Asset Backed Commercial Paper Conduit Program Overview

During January 2009, the U.S. Department of Education (ED), together with the Treasury Department and Office of Management and Budget (OMB), established the first federally guaranteed student loan Asset-Backed Commercial Paper (ABCP) Conduit Program. The ABCP Conduit Program was supported first by a liquidity facility provided by The Federal Financing Bank (a government corporation, under the general supervision of the Secretary of the Treasury) and second by a Put Agreement with ED to purchase eligible financed student loans.

Straight-A Funding, LLC (Conduit Lender) was a newly created Delaware LLC owned by Global Securitization Services, LLC. The Conduit Lender purchased funding notes from Funding Note Issuers at 97% of the balance of eligible loans (Subsidized and Unsubsidized Stafford, and PLUS loans) pledged and then issued Student Loan Short-Term Notes (SLST Notes) to investors in order to fund purchases of, or increases in, funding notes or repay existing SLST Notes.

The Conduit Lender used a multi-seller conduit approach whereby Sellers, such as PHEAA, receive a common cost of funds but retain the excess cash flow and control over their own pool of Financed Student Loans. Each Seller (PHEAA) established a Funding Note Issuer in the form of a bankruptcy-remote special purpose vehicle (PHEAA Student Loan Company (PHEAA SLC), PHEAA Student Loan Company II (PHEAA SLC II) and PHEAA Student Loan Company III (PHEAA SLC III)). The Seller receives an advance rate of 97% less upfront reserves and closing costs. The funding notes bear a variable interest rate, which is a mechanism for allocating the Conduit Lender's all-in cost of funds pro rata across the Funding Note Issuers.

The Federal Financing Bank (FFB) is a federal government entity providing a 5-year $60 billion liquidity facility that was established under a Liquidity Loan Agreement with the Conduit Lender for the SLST Notes. The liquidity facility matures on the Put expiration date.

We classified the notes associated with Asset Backed Commercial Paper Conduit Program (ABCP Conduit Program) as "student loan variable rate funding notes".

ABCP Conduit Program Transactions

PHEAA Student Loan Company (PHEAA SLC)

On June 17, 2009, PHEAA SLC entered into a Funding Note Purchase Agreement (FNPA) with Straight-A Funding (Conduit Lender) in which the Conduit Lender purchased the variable rate funding note at 97% of the collateral value. On that same date, PHEAA received $800.0 million, which the collateral value of the notes was $824.7 million. The FNPA states that the Funding Note Issuer (PHEAA SLC) shall repay in full the funding note balance and all accrued ratable financing costs on the final maturity date (December 5, 2013). On November 14, 2012, we entered into a bond refunding and repaid the outstanding debt under the Straight-A Funding Short-Term Note Facility (Straight-A Program). See "***Student loan auction rate bonds, floating rate notes, variable rate notes and financings***" above for details on the bond refunding that took place on November 14, 2012.

PHEAA Student Loan Company II (PHEAA SLC II)

On December 10, 2009, PHEAA SLC II entered into a Funding Note Purchase Agreement (FNPA) with Straight-A Funding (Conduit Lender) in which the Conduit Lender purchased the above variable rate funding note at 97% of the collateral value. On December 11, 2009, PHEAA received $436.4 million, which the collateral value of the notes was $449.9 million. The FNPA states that the Funding Note Issuer (PHEAA SLC I) shall repay in full the funding note balance and all accrued ratable financing costs on the final maturity date (December 5, 2013). As of June 30, 2013, the student loan variable rate funding note had an outstanding balance of $220.0 million. See the *"**Subsequent Event**"* section that follows for details on the bond refunding that took place on July 31, 2013.

PHEAA Student Loan Company III (PHEAA SLC III)

On December 16, 2009, PHEAA SLC III entered into a Funding Note Purchase Agreement (FNPA) with Straight-A Funding (Conduit Lender) in which the Conduit Lender purchased the above variable rate funding note at 97% of the collateral value. On January 19, 2010, PHEAA received $182.9 million, which the collateral value of the notes was $188.6 million. The FNPA states that the Funding Note Issuer (PHEAA SLC III) shall repay in full the funding note balance and all accrued ratable financing costs on the final maturity date (December 5, 2013). As of June 30, 2013, the student loan variable rate funding note had an outstanding balance of $99.0 million. See the *"**Subsequent Event**"* section that follows for details on the bond refunding that took place on July 31, 2013.

Subsequent Event

On March 18, 2013, the Foundation entered into a trust agreement creating the PHEAA Student Loan Trust 2013-2 as a statutory trust under the Delaware Statutory Trust Act, 12 *Del. C.* Section 3801. The principal purpose of the PHEAA Student Loan Trust 2013-2 is to securitize student loans and student loan related assets and to acquire student loans from the Foundation and issue one or more classes of securities secured by a pledge of assets. On July 30, 2013, the PHEAA Student Loan Trust 2013-2 issued $331.3 million of student loan asset backed notes with an interest rate of 1-month LIBOR plus 0.55% with a final maturity date of April 25, 2030. The proceeds from the sale of these notes, together with a $10.9 million of a capital contribution received indirectly through the Foundation from PHEAA, were used to purchase $341.0 million (principal and interest) of student loans, pay related costs of issuance and to fund an initial deposit to a reserve account created under the indenture.

On that same day, the PHEAA SLC II transferred $217.1 million of proceeds and the PHEAA SLC III transferred $97.8 million of proceeds from the above loan sale to repay our outstanding debt obligation under the Straight-A Funding Short-Term Note Facility (Straight-A Program). We classified this debt as "student loan variable rate funding notes" in the table on page 58. Following the release of the related liens under the Straight-A Program, we sold $317.4 million (principal and interest) of student loans to the Foundation for subsequent sale to the PHEAA Student Loan Trust 2013-2.

On that same day, in a separate transaction, we extinguished $4.8 million note purchase agreements with financial institutions for $1.5 million, which resulted in a $3.3 million gain on the early extinguishment of debt. We classified this debt as "Term Financings" in the section titled "Other financings" in the table on page 59.

Other financings

For the year ended June 30, 2013, the other financings had a net decrease of $52.0 million, which was due to an early extinguishment of debt that took place on November 14, 2012, and a bond refunding that took place on December 15, 2012. On November 14, 2012, in a separate transaction from the above mentioned bond refunding, we extinguished $45.4 million of term financings for $8.4 million, which resulted in a $37.0 million gain on the early extinguishment of debt. On December 15, 2012, we issued $37.2 million of Capital Acquisition Refunding Bonds, Series of 2012, at a premium for $41.9 million, with a weighted-average interest rate of 3.68% and a final maturity date of December 15, 2022. The proceeds from this issuance, as well as other proceeds, were used to purchase and cancel $45.6 million of the outstanding Capital Acquisition Refunding Bonds, Series of 2001, with a weighted-average interest rate of 5.09%.

Debt service requirements

The following table displays the debt service requirements based upon the stated maturities for the student loan auction rate bonds, floating rate notes, variable rate notes and financings, and the capital and other financings and estimated interest rates for the variable-rate debt.

(In thousands)	Student Loan Auction Rate Bonds, Floating Rate Notes, and Variable Rate Notes and Financings		Other Financings	
Year of Maturity	**Principal**	**Interest**	**Principal**	**Interest**
2014	$ 165,963	63,383	$ 3,635	1,801
2015	966,769	61,482	3,660	1,164
2016	-	61,257	3,745	1,028
2017	-	61,257	3,895	887
2018	59,150	61,167	4,055	740
2019-2023	127,970	302,958	18,245	1,369
2024-2028	648,419	296,375	-	-
2029-2033	416,945	264,216	11,107	-
2034-2038	2,663,196	246,136	-	-
2039-2043	434,600	124,654	-	-
2044-2048	1,988,001	40,931	-	-
	$ 7,471,013	1,583,816	$ 48,342	6,989

As of June 30, 2013, $7.5 billion of the $7.7 billion of the student loan auction rate bonds, floating rate notes and variable rate notes and financings were variable-rate debt, which have interest rates that reset on various dates. Of the $7.5 billion, interest rates on $13.8 million reset based on auctions every 7 days, $2.4 billion reset based upon auctions every 28 days, $127.9 million reset based upon auctions every 35 days, $3.7 billion is indexed to the 1-month or 3-month LIBOR, $966.8 million is indexed to the commercial paper rate and $319.1 million is conduit financing.

Notes and bonds payable, as well as all other debt, are limited obligations payable only from the pledged assets. We have no taxing power, and the Commonwealth is not obligated to pay the principal, redemption price, if any, or interest on any of our debt.

Note 9 – Other Long-Term Liabilities

Compensated Absences

Other long-term liabilities consist of compensated absences. In the table below, we present the changes in compensated absences as of and for the years ended June 30, 2013 and 2012:

As of and for the years ended June 30, (in thousands)		2013	2012
Balance as of July 1	$	**16,707**	15,253
Increases during the year		**2,379**	2,042
Decreases during the year		**(833)**	(588)
Balance as of June 30	$	**18,253**	16,707
Current portion	$	**833**	588
Long-term portion		**17,420**	16,119
Total compensated absences	$	**18,253**	16,707

Note 10 – Leases

Operating Lease

We lease office space, information technology and other equipment under operating leases expiring during the next six years. In most cases, we expect the leases to be renewed or replaced by other leases in the normal course of business. For the years ended June 30, 2013 and 2012, total operating lease expense was $17.1 million and $15.2 million, respectively.

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2013 are:

(In thousands)		
2014	$	18,457
2015		10,829
2016		10,250
2017		5,950
2018 and thereafter		11,627
Total minimum lease payments	$	57,113

Note 11 – Retirement and Other Postemployment Benefits

Retirement Plan

Plan Description

We contribute to the Commonwealth of Pennsylvania State Employees' Retirement System ("SERS"). SERS was established under the provisions of Public Law 858, No. 331. SERS is the administrator of a cost-sharing multiple-employer defined benefit retirement plan established by the Commonwealth 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 financial report as a pension trust fund.

SERS provides retirement, death, and disability 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.

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 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.

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 Act 120:

- Creates a new A-3 and an optional A-4 Class of Service for future non-judicial employees (Class A-3 members will contribute 6.25% of their pay toward their benefit, and they will accrue benefits at 2% 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".

As a pension trust fund of the Commonwealth, SERS issues an audited comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information. The SERS CAFR is available on-line at www.sers.state.pa.us, select "Publications" and select "CAFR – 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.

Funding Policy

The board of directors of SERS establishes our contribution requirements. Members are required to contribute to the plan and most member contribution rates are set at 6.25% of annual covered salary. As an employer, we are required to contribute at an actuarially determined rate. As noted above, the Governor signed Act 120 into law on November 23, 2010, which gradually increases funding with collars (limits) that cap employer contribution rate increases.

For the year ended June 30, 2014, the employer contribution rate will be 12.10% for the "A" Class of Service employees, 15.12% for the "AA" Class of Service employees and 10.46% for the "A-3" and "A-4" Class of Service employees. The majority of our employees are within the AA class of service. For the year ended June 30, 2013, the employer contribution rate was 8.43% for the "A" Class of Service employees, 10.51% for the "AA" Class of Service employees and 7.29% for the "A-3" and "A-4" Class of Service employees.

According to the Commonwealth of Pennsylvania SERS 2012 actuarial report, Schedule K, page 2 (Projection of Expected Contributions and Benefits – Reflecting Act 120 Collars), the blended fiscal projections indicate the employer's rate will increase to 18.3% in calendar year 2014, increase to 31.1% by calendar year 2018, and remain above 27% through calendar year 2023. For the years ended June 30, 2013, 2012 and 2011, our contributions were $12.0 million, $7.6 million and $4.4 million, respectively, and these contributions were equal to the required contributions set by SERS.

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, 2013. 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, a complete actuarial report is available for review at .www.budget.state.pa.us (select Financial Reports and under the heading "Special Reports" select "Actuarial Valuation of the Commonwealth's Post-Retirement Medical Plan (September 2011)).

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, 2013, 2012 and 2011, our annual contribution rate was $3.5 million, $3.3 million and $3.2 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, 2013, our contribution rate will be $297 thousand per month or $3.6 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 year ended June 30, 2012. The June 30, 2012, Commonwealth's CAFR can be accessed on-line at www.budget.state.pa.us, select "Financial Reports" and select "Comprehensive Annual Financial Reports".

Note 12 – 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, 2013 and 2012, total servicing revenues were $261.9 million and $234.7 million, respectively. For the years ended June 30, 2013 and 2012, we were servicing on average $154.0 billion and $114.6 billion, respectively, of loans for third party customers. For the years ended June 30, 2013 and 2012, customers using our servicing systems serviced on average $41.5 billion and $24.3 billion, respectively, of loans. For the years ended June 30, 2013 and 2012, other FFELP guarantors were managing on average $3.2 and $3.5 billion, respectively, of guarantees using our computer services.

Our servicing agreements, some of which expired during the fiscal year ended June 30, 2013, 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, 2013, three loan-servicing customers provided $153.5 million of servicing fees. No other individual customer provided servicing revenues that exceeded 5% of total servicing fees for the year ended June 30, 2013. For the year ended June 30, 2012, four loan-servicing customers provided $144.2 million of servicing fees.

Note 13 – Segment Information

We generally finance 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 this 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

For the years ended June 30 (in thousands)		2013	2012
Interest revenue	$	**144,385**	163,373
Interest expense		**(72,297)**	(98,304)
Net interest revenue		**72,088**	65,069
Provision for loan losses		**(4,397)**	(3,141)
Net interest revenue after provision for loan losses		**67,691**	61,928
Total noninterest revenue		**2,039**	91,643
Total operating revenues		**69,730**	153,571
Operating expenses		**(40,080)**	(44,726)
Operating income		**29,650**	108,845
Financial aid		**(3)**	(17)
Income before transfers		**29,647**	108,828
Transfers from (to) unrestricted net position		**64,507**	(160,967)
Changes in net position		**94,154**	(52,139)
Net position, beginning of period		**201,741**	253,880
Net position, end of period	$	**295,895**	201,741

Statements of Net Position

As of June 30 (in thousands)		2013	2012
Current assets:			
Restricted cash and cash equivalents	$	**229,620**	272,286
Student loans receivable, net		**1,064,946**	920,685
Interest income receivable		**113,760**	103,444
Other assets		**762**	113
Total current assets		**1,409,088**	1,296,528
Long-term assets:			
Student loans receivable, net		**6,543,439**	6,583,431
Deferred financing costs		**45,525**	38,974
Total long-term assets		**6,588,964**	6,622,405
Total assets		**7,998,052**	7,918,933
Current liabilities:			
Accounts payable and accrued expenses		**26,633**	27,960
Student loan financings and notes and bonds payable, net		**165,963**	120,000
Total current liabilities		**192,596**	147,960
Long-term liabilities:			
Student loan financings and notes and bonds payable, net		**7,509,561**	7,569,232
Total long-term liabilities		**7,509,561**	7,569,232
Total liabilities		**7,702,157**	7,717,192
Net position:			
Restricted for debt service		**295,895**	201,741
Total net position	$	**295,895**	201,741

Statements of Cash Flows

For the years ended June 30 (in thousands)		2013	2012
Cash flows from operating activities			
Interest received on student loans	$	**51,266**	218,677
Principal received on student loans		**1,051,389**	990,293
Student loan purchases		**(1,232,598)**	(7,533)
Student loan sales, including net gains and losses		**156,023**	595,990
Other		**386**	-
Payment of operating expenses		**(37,505)**	(54,477)
Net cash (used for) provided by operating activities		**(11,039)**	1,742,950
Cash flows from noncapital financing activities			
Proceeds from the issuance of noncapital debt		**2,700,995**	1,676,400
Principal paid on noncapital debt		**(2,694,611)**	(3,177,376)
Interest paid on student loan financings and notes and bonds payable		**(90,409)**	(113,355)
Other		**52,336**	(172,679)
Net cash used for noncapital financing activities		**(31,689)**	(1,787,010)
Cash flows from investing activities			
Interest received on investments		**62**	172
Net cash provided by investing activities		**62**	172
Net change in restricted cash and cash equivalents		**(42,666)**	(43,888)
Restricted cash and cash equivalents, beginning of period		**272,286**	316,174
Restricted cash and cash equivalents, end of period	$	**229,620**	272,286

There are fourteen separate trusts with parity ratios, a ratio of assets to liabilities. As of June 30, 2013, the trusts had parity ratios ranging from 1.028 to 1.137. Three of the fourteen trusts have a minimum parity ratio requirement and as of June 30, 2013, the three trusts complied with the minimum parity ratio requirement. As of June 30, 2012, one trust had a parity ratio of 0.935 and the remaining trusts had parity ratios ranging from 1.024 to 1.122.

As of June 30, 2013 and 2012, the 1997 Master Trust that issued auction rate securities held $2.2 billion and $3.2 billion of debt, respectively. As of June 30, 2013 and 2012, the parity ratio for this trust was 1.064 and 1.036, respectively. This trust does not have a parity ratio requirement.

Note 14 – Blended Component Units

We consider the PHEAA Student Loan Trust I (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 Company (PHEAA SLC), the PHEAA Student Loan Company II (PHEAA SLC II) and the PHEAA Student Loan Company III (PHEAA SLC III) blended component units (BCUs) of the PHEAA Student Loan Foundation (Foundation), and the Pennsylvania Higher Education Foundation (PHEF) a BCU of PHEAA.

The Trust, the 2011-1 Trust, the 2012-1 Trust and the 2013-1 Trust, collectively "PHEAA SLTs", are legally separate entities and we consider them 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 to the Foundation.

The PHEAA SLC, PHEAA SLC II and PHEAA SLC III, collectively "PHEAA SLCs", are legally separate entities and we consider them component units of the Foundation, because the Foundation appointed the PHEAA SLCs governing body and the Foundation could impose its will on the PHEAA SLCs. The PHEAA SLCs are BCUs of the Foundation, because they provide services entirely to 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 consider 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.

As legally separate entities, the student loan financings and notes and bonds payable, 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 for the BCUs mentioned above.

Statements of Revenues, Expenses and Changes in Net Position

For the year ended June 30, 2013 (in thousands)		PHEAA SLCs	PHEAA SLTs	Foundation (Total PHEAA SLCs and SLTs)	PHEF	Total BCUs
Interest revenue	$	**11,984**	**50,204**	**62,188**	**2**	**62,190**
Interest expense		**(6,187)**	**(11,758)**	**(17,945)**	**-**	**(17,945)**
Net interest revenue		**5,797**	**38,446**	**44,243**	**2**	**44,245**
Provision for loan losses		**-**	**(3,158)**	**(3,158)**	**-**	**(3,158)**
Net interest revenue after provision for loan losses		**5,797**	**35,288**	**41,085**	**2**	**41,087**
Total noninterest revenue		**(917)**	**38**	**(879)**	**-**	**(879)**
Total operating revenues		**4,880**	**35,326**	**40,206**	**2**	**40,208**
Operating expenses		**(4,088)**	**(13,373)**	**(17,461)**	**(4)**	**(17,465)**
Operating income (loss)		**792**	**21,953**	**22,745**	**(2)**	**22,743**
Total transfers		**(29,393)**	**15,193**	**(14,200)**	**(152)**	**(14,352)**
Changes in net position		**(28,601)**	**37,146**	**8,545**	**(154)**	**8,391**
Net position, beginning of period		**43,508**	**(57,861)**	**(14,353)**	**1,215**	**(13,138)**
Net position, end of period	$	**14,907**	**(20,715)**	**(5,808)**	**1,061**	**(4,747)**

For the year ended June 30, 2012 (in thousands)		PHEAA SLCs	PHEAA SLTs	Foundation (Total PHEAA SLCs and SLTs)	PHEF	Total BCUs
Interest revenue	$	23,516	47,687	71,203	2	71,205
Interest expense		(9,933)	(13,959)	(23,892)	-	(23,892)
Net interest revenue		13,583	33,728	47,311	2	47,313
Provision for loan losses		-	(2,930)	(2,930)	-	(2,930)
Net interest revenue after provision for loan losses		13,583	30,798	44,381	2	44,383
Total noninterest revenue		(1,507)	94,199	92,692	-	92,692
Total operating revenues		12,076	124,997	137,073	2	137,075
Operating expenses		(7,528)	(11,156)	(18,684)	(25)	(18,709)
Operating income (loss)		4,548	113,841	118,389	(23)	118,366
Non-operating losses		-	-	-	(32)	(32)
Income (loss) before transfers		4,548	113,841	118,389	(55)	118,334
Total transfers		(13,852)	(206,171)	(220,023)	(24)	(220,047)
Changes in net position		(9,304)	(92,330)	(101,634)	(79)	(101,713)
Net position, beginning of period		52,812	34,469	87,281	1,294	88,575
Net position, end of period	$	43,508	(57,861)	(14,353)	1,215	(13,138)

Statements of Net Position

As of June 30, 2013 (in thousands)		PHEAA SLCs	PHEAA SLTs	Foundation (Total PHEAA SLCs and SLTs)	PHEF	Total BCUs
Current assets:						
Restricted cash and cash equivalents	$	9,675	65,299	74,974	765	75,739
Restricted investments		-	-	-	296	296
Student loans receivable, net		38,379	447,295	485,674	-	485,674
Interest income receivable		4,181	40,065	44,246	-	44,246
Other assets		-	7	7	-	7
Total current assets		52,235	552,666	604,901	1,061	605,962
Long-term assets:						
Student loans receivable, net		280,914	2,333,117	2,614,031	-	2,614,031
Other assets		75	26,196	26,271	-	26,271
Total long-term assets		280,989	2,359,313	2,640,302	-	2,640,302
Total assets		333,224	2,911,979	3,245,203	1,061	3,246,264
Current liabilities:						
Accounts payable and accrued expenses		236	13,478	13,714	-	13,714
Student loan financings and notes and bonds payable		4,663	-	4,663	-	4,663
Total current liabilities		4,899	13,478	18,377	-	18,377
Long-term liabilities:						
Student loan financings and notes and bonds payable, net		313,418	2,919,216	3,232,634	-	3,232,634
Total long-term liabilities		313,418	2,919,216	3,232,634	-	3,232,634
Total liabilities		318,317	2,932,694	3,251,011	-	3,251,011
Net position:						
Restricted for debt service		14,907	(20,715)	(5,808)	-	(5,808)
Restricted for financial aid grant programs		-	-	-	1,061	1,061
Total net position	$	14,907	(20,715)	(5,808)	1,061	(4,747)

As of June 30, 2012 (in thousands)		PHEAA SLCs	PHEAA SLTs	Foundation (Total PHEAA SLCs and SLTs)	PHEF	Total BCUs
Current assets:						
Restricted cash and cash equivalents	$	40,537	74,141	114,678	923	115,601
Restricted investments		-	-	-	300	300
Student loans receivable, net		129,116	234,531	363,647	-	363,647
Interest income receivable		14,978	25,917	40,895	-	40,895
Other assets		-	5	5	-	5
Total current assets		184,631	334,594	519,225	1,223	520,448
Long-term assets:						
Student loans receivable, net		792,578	1,722,655	2,515,233	-	2,515,233
Other assets		244	18,910	19,154	-	19,154
Total long-term assets		792,822	1,741,565	2,534,387	-	2,534,387
Total assets		977,453	2,076,159	3,053,612	1,223	3,054,835
Current liabilities:						
Accounts payable and accrued expenses		679	10,134	10,813	8	10,821
Total current liabilities		679	10,134	10,813	8	10,821
Long-term liabilities:						
Student loan financings and notes and bonds payable, net		933,266	2,123,886	3,057,152	-	3,057,152
Total long-term liabilities		933,266	2,123,886	3,057,152	-	3,057,152
Total liabilities		933,945	2,134,020	3,067,965	8	3,067,973
Net position:						
Restricted for debt service		43,508	(57,861)	(14,353)	-	(14,353)
Restricted for financial aid grant programs		-	-	-	1,215	1,215
Total net position	$	43,508	(57,861)	(14,353)	1,215	(13,138)

Statements of Cash Flows

For the year ended June 30, 2013 (in thousands)		PHEAA SLCs	PHEAA SLTs	Foundation (Total PHEAA SLCs and SLTs)	PHEF	Total BCUs
Net cash provided by (used for) operating activities	$	**619,804**	**(800,581)**	**(180,777)**	**(12)**	**(180,789)**
Net cash provided by (used for) noncapital financing activities		**(650,666)**	**791,709**	**141,043**	**(152)**	**140,891**
Net cash provided by investing activities		**-**	**30**	**30**	**6**	**36**
Net change in restricted cash and cash equivalents		**(30,862)**	**(8,842)**	**(39,704)**	**(158)**	**(39,862)**
Restricted cash and cash equivalents, beginning of period equivalents		**40,537**	**74,141**	**114,678**	**923**	**115,601**
Restricted cash and cash equivalents, end of period equivalents	$	**9,675**	**65,299**	**74,974**	**765**	**75,739**

For the year ended June 30, 2012 (in thousands)		PHEAA SLCs	PHEAA SLTs	Foundation (Total PHEAA SLCs and SLTs)	PHEF	Total BCUs
Net cash provided by (used for) operating activities	$	220,827	(1,352,877)	(1,132,050)	(48)	(1,132,098)
Net cash provided by (used for) noncapital financing activities		(214,074)	1,405,830	1,191,756	(24)	1,191,732
Net cash provided by investing activities		-	68	68	150	218
Net change in restricted cash and cash equivalents		6,753	53,021	59,774	78	59,852
Restricted cash and cash equivalents, beginning of period equivalents		33,784	21,120	54,904	845	55,749
Restricted cash and cash equivalents, end of period equivalents	$	40,537	74,141	114,678	923	115,601

Note 15 – Restrictions on 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, 2013, unrestricted net position amounted to $558.6 million of which net position related to the guaranty activities was $157.5 million. As of June 30, 2012, unrestricted net position amounted to $486.3 million of which net position related to the guaranty activities was $111.0 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, 2013, net position restricted for debt service amounted to $295.9 million. As of June 30, 2012, net position restricted for debt service amounted to $201.7 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, 2013, net position restricted for financial aid grant programs amounted to $36.6 million. As of June 30, 2012, net position restricted for financial aid grant programs amounted to $52.2 million.

Note 16 – Risk Management, Contingencies, and Legal Proceedings

Risk Management and Contingencies

We are exposed to various risks of loss, such as theft, damage to and destruction of assets. To handle those risks, we purchase insurance coverage, and there have been no material claims. We are also exposed to risk of loss in an evolving regulatory environment. To date, there has been no material supervisory or enforcement actions or findings. We have been reasonably forward-looking in order to anticipate and appropriately respond to changes with the evolving regulatory standards.

Federal programs in which we participate are subject to audit in accordance with the provisions of the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. The provisions of this circular 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

On August 26, 2009, PHEAA was served with a copy of a First Amended Complaint in the matter of *Jon H. Oberg v. Nelnet, Inc., et al.*, Civil No. 1:07-cv-960, pending in the United States District Court for the Eastern District of Virginia. This is a Federal False Claims Act case filed by a former employee of ED. The matter was originally filed under seal in 2007, and the plaintiff was not permitted to serve the defendants until August 2009. ED elected not to intervene in the prosecution of the action. In short, the plaintiff alleged that PHEAA and the other named defendants illegally submitted claims for 9.5% floor loan special allowance payments in violation of applicable law and regulatory guidance. Separately, PHEAA resolved a program review finding with ED regarding a discrete portion of its 9.5% floor loan portfolio and received through requisite audits by ED's independent auditing firm approval to continue billing its 1^{st} and 2^{nd} generation 9.5% floor loans.

As for the lawsuit, on December 1, 2009, the trial court granted PHEAA's request to dismiss the lawsuit as to PHEAA. Thereafter, the plaintiff's attorney advised that he may appeal this decision once the lawsuit resolved as to the additional defendants. Subsequently, the additional defendants settled and on November 18, 2010, a Final Order was entered in this matter, which, among other things, placed the previously dismissed claim against PHEAA among the ended causes. The plaintiff filed a Notice of Appeal on November 22, 2010. Previously dismissed parties filed their brief with the United States Court of Appeals for the Fourth Circuit on April 12, 2011. Oral argument was held, and on June 18, 2012, the United States Court of Appeals for the Fourth Circuit vacated and remanded to the United States District Court in order for the United States District Court to make findings of fact and to apply the arm-of-the-state analysis. Shortly thereafter, Oberg filed a motion to amend the complaint, and following oral argument on August 31, 2012, Oberg's motion was granted. Over Oberg's objections, the Court permitted the Defendants 20 days to file responses to the amended complaint and permitted the Defendants to file individual motions and briefs. We filed a motion to dismiss for which oral arguments were scheduled for October 12, 2012. Later, the Court declined to hear oral arguments and subsequently issued an order on October 24, 2012, which granted PHEAA's motion to dismiss, struck the matter from the active docket and noted that a Memorandum Opinion would be forthcoming. The Court issued the Memorandum Opinion on December 5, 2012, wherein the Court determined that under the arm-of-the-state analysis, PHEAA was not a person subject to the False Claims Act. On December 7, 2012, Oberg appealed the Court's decision.

On January 31, 2013, Oberg filed his brief, and on March 4, 2013, we filed our brief in response. Oberg filed a reply brief on March 18, 2013. An appellee was voluntarily dismissed on April 12, 2013. Regarding oral argument, on February 8, 2013, the United States Court of Appeals Fourth Circuit Court tentatively scheduled oral argument for the argument session of May 14, 2013 through May 17, 2013, and then on the same day removed this case from the calendar for the oral argument session of May 14, 2013 through May 17, 2013. On April 11, 2013, Oberg filed a motion to expedite argument. On April 18, 2013, we filed our motion in opposition to expediting argument to which Oberg filed a reply motion on April 19, 2013. On May 1, 2013, the United States Court of Appeals for the Fourth Circuit denied Oberg's motion to expedite argument. As of June 30, 2013, we believe it is remote that a loss contingency exists, and we will continue to contest this matter vigorously. Subsequently on September 19, 2013, the United States Court of Appeals for the Fourth Circuit held oral arguments.

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, 2013.