Annual Financial Report
June 30, 2018 and 2017

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

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

Building a better working world

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, 2018 and 2017, and the related notes to the financial statements, which collectively comprise PHEAA's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of PHEAA at June 30, 2018 and 2017, and the results of changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Adoption of New Accounting Pronouncement

As discussed in Note 4 to the financial statements, as of July 1, 2017, the Agency adopted Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Plans Other Than Pension Plans*. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, the required schedules of PHEAA's proportionate share of the net pension liability, PHEAA's contributions, and changes in the total Other Postemployment Benefits liability and related ratios on pages 5 - 32 and 73 - 74 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Ernst & Young LLP

Baltimore, Maryland
September 20, 2018

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

About PHEAA

The Pennsylvania General Assembly created PHEAA in 1963 and PHEAA has evolved into one of the nation's leading student aid organizations. Today, PHEAA is a national provider of student financial aid services, serving millions of students and thousands of schools through its loan guaranty, loan servicing, financial aid processing, outreach, and other student aid programs.

PHEAA's earnings are used to support its public service mission and to pay its operating costs, including administration of the Pennsylvania State Grant and other state-funded student aid programs. PHEAA continues to devote its energy, resources, and imagination to developing innovative ways to ease the financial burden of higher education for students, families, schools, and taxpayers. PHEAA conducts its student loan servicing activities nationally as American Education Services ("AES") and FedLoan Servicing ("FLS").

PHEAA is governed by a twenty-member Board of Directors ("Board"), four of whom are appointed by the Governor of Pennsylvania ("Governor"), and sixteen others designated by the Pennsylvania Legislature ("Legislature"). The Board is responsible for our strategic direction by adopting sound, ethical, and legal governance and financial management policies, as well as ensuring the Agency has adequate resources to advance its mission. The President/Chief Executive Officer and Executive Management of the Agency are responsible for administering these policies in an efficient and timely manner.

Our business activities are subject to regulation and supervision by the United States Department of Education ("ED"), Bureau of Consumer Financial Protection, Federal Financial Institutions Examination Council, the Commonwealth of Pennsylvania, and various authorities in the states in which we do business. In addition, our activities are subject to audit by the Pennsylvania Department of the Auditor General, and we are required to make an annual report to the Governor and the Legislature presenting our financial condition at the end of the Commonwealth's fiscal year.

We have 3,374 employees and contractors, and our principal offices are located in Harrisburg, Pennsylvania, with four regional offices located throughout Pennsylvania.

Public Service Benefits and Grant Programs

On June 22, 2017, the Board of Directors authorized the President/Chief Executive Officer to allocate funds to the following grant programs for fiscal year 2017-2018:

- Pennsylvania State Grant Program - $87.0 million;
- Pennsylvania Distance Education Program - $10.0 million; and
- Pennsylvania Targeted Industry Cluster Certificate Scholarship Program - $6.0 million.

On July 10, 2017, House Bill No. 218 (appropriations bill for fiscal year 2017-2018) became law and section 218 allocated funding levels to the following programs for fiscal year 2017-2018:

- Pennsylvania State Grant Program - $273.4 million;
- Institutional Assistance Grant Program - $25.7 million;
- Matching Funds Grant Program - $12.5 million;
- Pennsylvania Ready to Succeed Scholarship Program - $5.0 million;
- Higher Education for the Disadvantaged Program - $2.2 million;
- Cheyney University Keystone Academy Program - $1.8 million;
- Horace Mann Bond-Leslie Pickney Hill Scholarship for outreach and recruitment activities at Lincoln and Cheyney Universities Program - $697 thousand;

- o Pennsylvania Internships Program Grants - $350 thousand; and
- o Higher Education of Blind or Deaf Program - $47 thousand.

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

(Dollars in thousands)

For the years ended June 30,	2018	2017	2016
Self-funded			
Pennsylvania State Grant Program Supplement	**$ 87,000**	$ 87,000	$ 125,000
Costs of operating state and federal governmental programs	**15,967**	16,552	15,313
Pennsylvania Distance Education Program Supplement, net of refunds	**10,339**	12,974	10,323
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds	**6,141**	6,990	4,886
Other public service activities and outreach	**5,714**	3,089	2,910
Total Self Funded	**$ 125,161**	$ 126,605	$ 158,432

For the year ended June 30, 2018, we transferred: $87.0 million from the Pennsylvania State Grant Program Supplement fund to the Pennsylvania State Grant Program; we transferred $10.0 million to the Pennsylvania Distance Education Program and disbursed $10.3 million, net of refunds from the program; and we transferred $6.0 million to the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program and disbursed $6.1 million, net of refunds from the program.

The Pennsylvania Department of Health provides loan repayment opportunities as an incentive to recruit and retain primary care practitioners willing to serve underserved Pennsylvania residents and to make a commitment to practicing in federally designated Health Professional Shortage Areas. We are working with the Pennsylvania Department of Health by providing funding for this loan forgiveness program. On October 30, 2017, Act No. 2017-44 (P.L. 725, No. 44) became law and, per section 1738-F(1) PHEAA entered into an agreement with the Pennsylvania Department of Health to transfer up to $4.55 million from the Higher Education Assistance Fund to the Pennsylvania Department of Health for the Children's Health Care Act. As of June 30, 2018, we disbursed $4.5 million, net of refunds from the Pennsylvania Health Care Loan Forgiveness Program.

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

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

(Dollars and numbers in actual amounts)

Award year	**2017-2018**	2016-2017	2015-2016
Maximum grant award	**$4,123**	$4,378	$4,340
Grant recipients (approximate number)	**140,000**	143,000	154,000

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

- The Matching Funds Program provides financial assistance to higher education institutions to assist them in capturing federal funds that require a state or local match as part of the federal grant award. It also provides matching grants to scholarship awards made by selected non-profit foundations.

- The Pennsylvania National Guard Education Assistance Program (“EAP”) is for members of the Pennsylvania National Guard. This program provides tuition assistance for students who enter into a service commitment with the Pennsylvania National Guard, typically for a period of six years. The maximum EAP award for full-time students (undergraduates) is the lesser of the actual tuition charged for the full-time course of study, or 100% of the tuition charged to a Pennsylvania resident at a state-owned university.

- The Postsecondary Educational 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.

- The Ready To Succeed Scholarship Program (“RTSS”) provides awards to high achieving students whose annual family income does not exceed $110,000. The post-secondary institution must nominate the student for participation in RTSS, and the awards from the RTSS may be used for tuition, books, fees, supplies, and living expenses.

- The Pennsylvania Department of Treasury created the Keystone Scholars program with the purpose of providing a $100 grant at birth as a starter step to encourage all Pennsylvania families to plan for their children’s higher education. The demonstration project will be available for families residing in Delaware, Elk, Indiana, Luzerne, Mifflin and Westmoreland counties. The program’s funds were designated for any baby born or adopted in 2018 and 2019 to families living in the six-county area. On January 18, 2018, PHEAA’s Board of Directors authorized PHEAA to (1) use up to $2.3 million of available funds of the Agency to (a) make contributions of $100 per child born in the Commonwealth to one or more accounts established to receive such deposits (the aggregate of such deposits not to exceed $1.5 million), and (b) to fund outreach programs, research, and financial literacy education programs for parents in conjunction with the Office of the Treasurer in an amount not to exceed $750 thousand; and (2) to administer the Keystone Accounts Demonstration Program in accordance with the terms of the Interagency Agreement subject to the approval of the Board.

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. Our primary operations involve servicing activities, student loan holdings and guaranty activities. In the table that follows, we present our total assets managed.

(Dollars in thousands)

As of June 30,	2018	2017	2016
Servicing:			
Commercial servicing:			
Client-owned loans	**$ 32,081,159**	$ 35,955,741	$ 40,378,802
PHEAA and PHEAA Student Loan Trust owned student loans	**4,594,988**	5,030,940	5,947,255
Total commercial servicing	**36,676,147**	40,986,681	46,326,057
Federal servicing	**320,075,849**	295,842,021	264,640,157
Remote servicing			
Federal servicing	**47,026,516**	38,851,713	34,189,955
Commercial servicing	**21,552,326**	17,079,248	13,291,354
Total remote servicing	**68,578,842**	55,930,961	47,481,309
Total servicing	**425,330,838**	392,759,663	358,447,523
Guaranty:			
Original principal outstanding	**23,284,875**	26,125,091	29,013,133
Inventory of defaulted loans	**3,917,188**	4,103,245	4,741,697
Total guaranty	**27,202,063**	30,228,336	33,754,830
Total assets managed	**$ 452,532,901**	$ 422,987,999	$ 392,202,353

Servicing Activities

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

Commercial Servicing

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

FLS Servicing

Our FLS line of business services FFEL and William D. Ford ("Direct Loan") program loans owned by the United States Department of Education. We are one of four Title IV Additional Servicers ("TIVAS") that service student loans owned by ED. Our contract expires on June 16, 2019. ED uses a common set of metrics to measure the performance of each federal loan servicer and a common calculation methodology to allocate new loan volume to all servicers.

ED is embarking on a new transformation initiative known as the Next Generation Financial Services Environment ("NextGen"). Through this initiative, the Federal Government seeks to implement a flexible, world-class financial solution to leverage in supporting its citizens. On February 20, 2018, ED, Office of Federal Student Aid ("FSA") posted Phase 1 of the NextGen solution. Phase 1 is part of a two-phase source selection and FSA anticipates utilizing a commercial solution(s) to meet the objectives of this initiative. Phase 1 consists of nine components and vendors may provide a response for an individual, multiple, or all component(s). The submission deadline for Phase 1 was April 18, 2018, and we submitted a timely offer to ED.

Remote Servicing

Our Remote Servicing line of business provides our system to guarantors, Not-for-Profit ("NFP") and other servicers to use in their internal servicing operations.

Student Loan Holdings

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

Guaranty Activities

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

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

▪ Before October 1, 1993	80% - 100%
▪ Between October 1, 1993 and September 30, 1998	78% - 98%
▪ Between October 1, 1998 and November 30, 2015	75% - 95%

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

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

- For any student loan that was rehabilitated on or after August 14, 2008, the borrower cannot rehabilitate the student loan again if the student loan returns to default status following the rehabilitation;
- A judgment has been obtained on the loan;
- Default claims were filed on the loan under the Code of Federal Regulations, Title 34, Chapter VI, Sec. 682.412 (Consequences of the failure of a borrower or a student to establish eligibility); and

- The borrower has been convicted of, or has pled nolo contendere or guilty to, a crime involving fraud in obtaining Title IV, Higher Education Act program assistance.

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

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

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

For more information on the Federal Fund, see the section titled "**Federal Student Loan Reserve Fund (Federal Fund)**" within the MD&A.

Description of the Basic Financial Statements

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

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

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

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

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

Condensed Financial Information

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the years ended June 30,	**2018**	2017	2016
Student loan interest revenue, net	**$ 157,952**	$143,789	$147,512
Investment interest revenue	**16,051**	15,961	6,615
Total interest revenue	**174,003**	159,750	154,127
Interest expense on student loan financings, net	**(72,951)**	(37,781)	(37,324)
Interest expense on other financings, net	**(348)**	(425)	(502)
Total interest expense	**(73,299)**	(38,206)	(37,826)
Net interest revenue	**100,704**	121,544	116,301
Provision for loan losses	**(3,538)**	(3,895)	(6,741)
Net interest revenue after provision for loan losses	**97,166**	117,649	109,560
Total noninterest revenue	**484,620**	519,031	515,867
Operating revenues	**581,786**	636,680	625,427
Total operating expenses	**(560,308)**	(570,923)	(528,615)
Operating income	**21,478**	65,757	96,812
Total grants and financial aid, net	**(104,326)**	(130,436)	(149,121)
Changes in net position	**(82,848)**	(64,679)	(52,309)
Net position, beginning balance **(restated)**	**304,364**	751,711	804,020
Net position, ending balance	**$ 221,516**	$687,032	$751,711

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

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

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

On July 1, 2017, we adopted GASB Statement No. 75 and as a result, we restated beginning net position. See **Note 4 – Change in Accounting Principle** for more details.

Statements of Net Position

(Dollars in thousands)

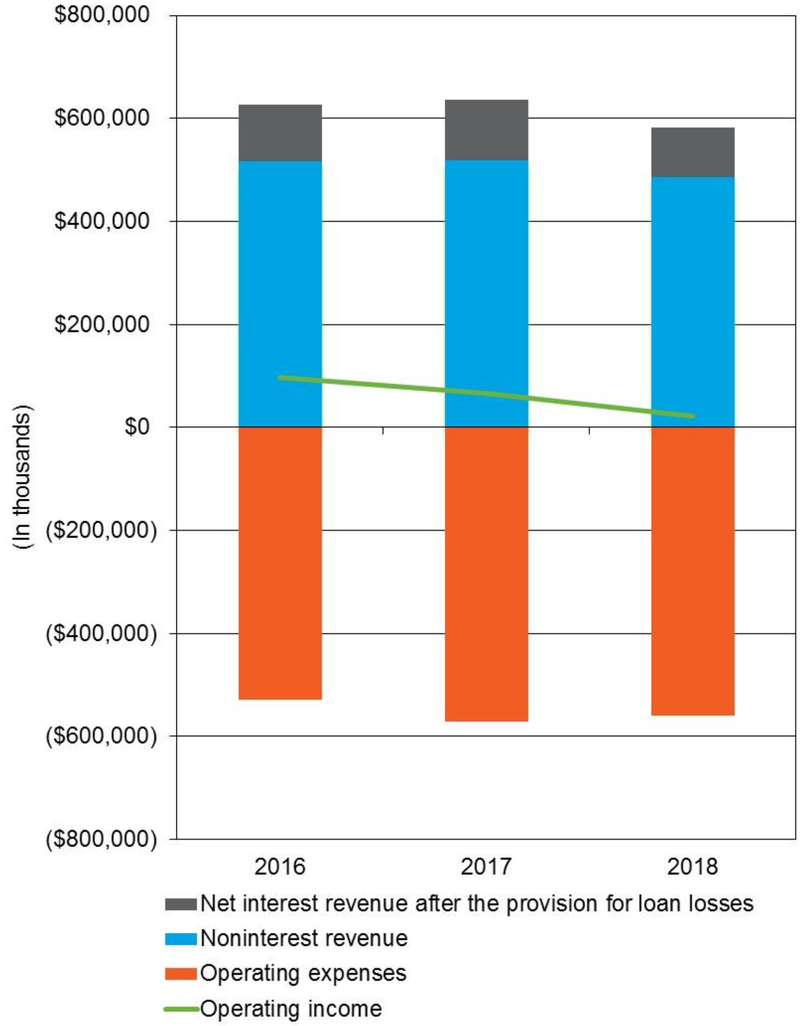
As of June 30,	**2018**	2017	2016
Current assets:			
Cash, cash equivalents and investments (restricted and unrestricted)	**$ 749,675**	$1,097,158	$ 950,524
Student loans receivable	**752,702**	788,882	962,917
Other assets	**237,487**	193,122	237,157
Total current assets	**1,739,864**	2,079,162	2,150,598
Long-term assets:			
Student loans receivable, net	**3,822,546**	4,224,277	4,955,122
Capital assets, net	**91,025**	88,238	79,087
Total long-term assets	**3,913,571**	4,312,515	5,034,209
Total assets	**5,653,435**	6,391,677	7,184,807
Total deferred outflow of resources	**83,324**	134,810	128,125
Current liabilities:			
Student loan financings	**240,000**	200,000	938,213
Other liabilities	**227,876**	257,980	242,884
Total current liabilities	**467,876**	457,980	1,181,097
Long-term liabilities:			
Student loan financings, net	**4,108,779**	4,762,797	4,751,841
Net pension liability	**413,878**	474,743	440,673
Other postemployment benefit liability	**357,062**	-	-
Other liabilities	**44,632**	49,829	52,316
Total long-term liabilities	**4,924,351**	5,287,369	5,244,830
Total liabilities	**5,392,227**	5,745,349	6,425,927
Total deferred inflow of resources	**123,016**	94,106	135,294
Net position			
Net investment in capital assets	**91,025**	88,238	79,087
Restricted for debt service	**341,848**	305,780	310,324
Restricted for financial aid grant programs	**33,035**	29,305	52,079
Unrestricted	**(244,392)**	263,709	310,221
Total net position	**$ 221,516**	$ 687,032	$ 751,711

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

Student loan financings are net of the discounts on student loan floating rate notes.

Results of Operations

Years ended June 30



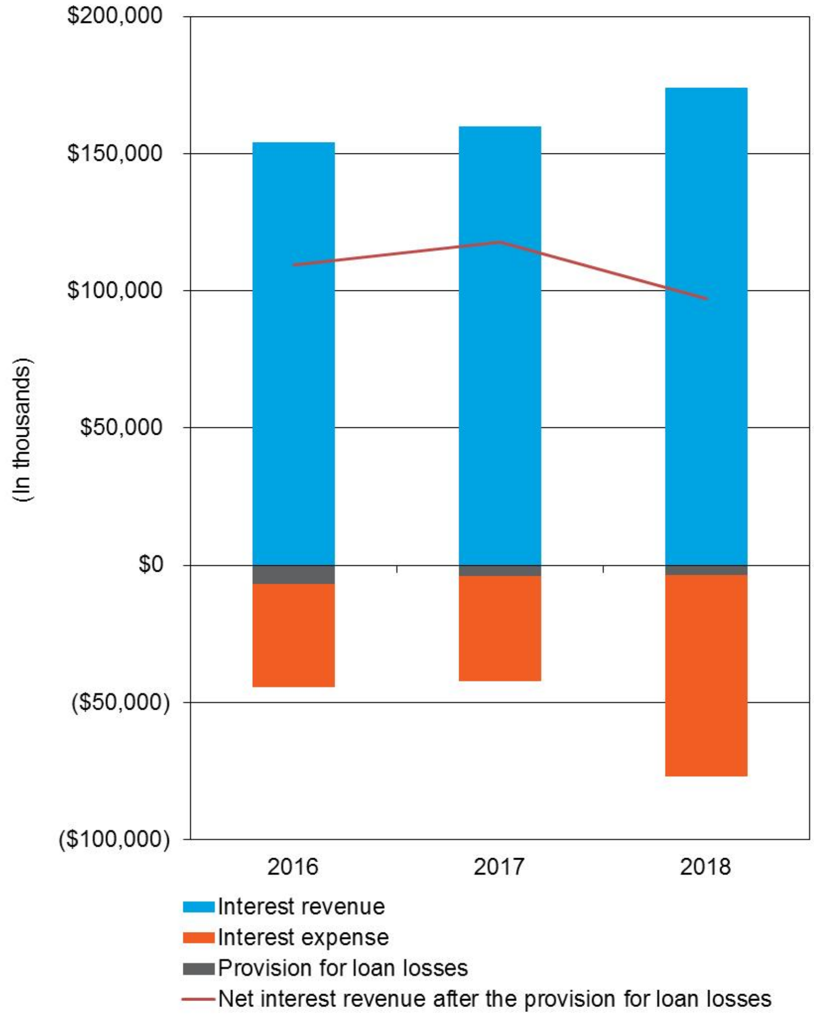
Operating income for the year ended June 30, 2018, was $21.5 million, a 67.3% decrease from $65.8 million in 2017. Operating revenues were $581.8 million in 2018, an 8.6% decrease from $636.7 million in 2017. Net interest revenue after the provision for loan losses was $97.2 million in 2018, a 17.3% decrease from $117.6 million in 2017. Noninterest revenue was $484.6 million in 2018, a 6.6% decrease from $519.0 million in 2017. Operating expenses were $560.3 million in 2018, a 1.9% decrease from $570.9 million in 2017.

Operating income for the year ended June 30, 2017, was $65.8 million, a 32.2% decrease from $96.8 million in 2016. Operating revenues were $636.7 million in 2017, a 1.8% increase from $625.4 million in 2016. Net interest revenue after the provision for loan losses was $117.6 million in 2017, a 7.3% increase from $109.6 million in 2016. Noninterest revenue was $519.0 million in 2017, a 0.6% increase from $515.9 million in 2016. Operating expenses were $570.9 million in 2017, an 8.0% increase from $528.6 million in 2016.

A more detailed explanation of the results of operations follows.

Net Interest Revenue after the Provision for Loan Losses

Years ended June 30



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

For the year ended June 30, 2018, net interest revenue after the provision for loan losses was $97.2 million, a 17.3% decrease from $117.6 million in 2017. The decrease was mainly due to the decline in the net interest margin as our variable rate debt costs increased faster than the rate on the student loans associated with the debt, and a decline in the amortization of the deferred gains on bond refundings.

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

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

Net Interest Spread and Margin

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

For the years ended June 30,	**2018**	2017	2016
Student loan yield	**3.31%**	2.62%	2.30%
Investment yield	**1.77%**	1.54%	0.64%
Total interest yield	**3.07%**	2.45%	2.07%
Student loan financings rate	**(1.56%)**	(0.69%)	(0.59%)
Other financing rate	**(1.26%)**	(1.32%)	(1.37%)
Total interest rate	**(1.56%)**	(0.69%)	(0.59%)
Net interest spread	**1.51%**	1.76%	1.48%
Net interest margin	**1.77%**	1.86%	1.56%
Average balances (in thousands)			
Student loans	**$ 4,771,800**	$5,482,467	$6,426,870
Investments	**904,333**	1,038,770	1,034,994
Student loan financings	**4,673,548**	5,480,187	6,370,538
Other financings	**27,713**	32,231	36,678

Rate and Volume Analysis

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

As of June 30, 2018, the 91-day U.S. Treasury Bill rate was used to calculate special allowance for 3% of the student loan portfolio, the 3-month financial commercial paper rate was used to calculate special allowance for 10% of the student loan portfolio, and the 1-month LIBOR was used to calculate special allowance for 87% of the student loan portfolio.

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

(Dollars in thousands)	**2018 vs. 2017**			2017 vs. 2016		
		Increase (decrease) attributable to change in			Increase (decrease) attributable to change in	
For the years ended June 30	**Increase (decrease)**	**Rate**	**Volume**	Increase (decrease)	Rate	Volume
Student loan interest revenue, net	$ 14,163	$ 32,748	$ (18,585)	$ (3,723)	$ 20,129	$ (23,852)
Investment interest revenue:						
Investment income	4,981	6,080	(1,099)	3,512	3,494	18
Fair value adjustments	(4,891)	(3,925)	(966)	5,834	5,828	6
Total interest revenue	14,253	34,903	(20,650)	5,623	29,451	(23,828)
Student loan financings interest expense, net	35,170	40,731	(5,561)	457	4,881	(4,424)
Other financings interest expense, net	(77)	(17)	(60)	(77)	(17)	(60)
Total interest expense	35,093	40,714	(5,621)	380	4,864	(4,484)
Net interest revenue	$ (20,840)	$ (5,811)	$ (15,029)	$ 5,243	$ 24,587	$ (19,344)

2018 vs. 2017 – Changes in Rate and Volume

For the year ended June 30, 2018, the increase in the rate of our student loan interest revenue, net, was due to an increase in student loan yields because of a decrease in the negative special allowance payments and the consolidation loan rebate fees paid by PHEAA. The decrease in the volume of our student loan interest revenue, net, was due to a decreasing student loan portfolio resulting from borrower payments, claim and consolidation payoffs.

For the year ended June 30, 2018, the increase in rate on investment income was due to an increase in the dividend rate earned on our investments in the Commonwealth's Treasury Investment Pool. This increase was partially offset by a decrease in rate of the fair value adjustment income due to a decrease in the Net Asset Value ("NAV") on our investments in the Commonwealth's Treasury Investment Pool.

For the year ended June 30, 2018, the increase in the rate of our student loan financings interest expense, net, was due to an increase in the 1-month LIBOR and 3-month LIBOR and a decrease in the amortization of the deferred gain on bond refundings. The decrease in volume of our student loan interest expense, net, was due to principal payments made on our student loan financing debt.

2017 vs. 2016 – Changes in Rate and Volume

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

For the year ended June 30, 2017, the increase in the rate of our investment income was due to an increase in the dividends earned from our investments at the Commonwealth's Treasury Investment Pool. The increase in the rate of the fair value adjustments was mainly due to an increase in the NAV of our investments at the Commonwealth's Treasury Investment Pool.

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

Provision for loan losses

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

(Dollars in thousands)

For the years ended June 30,	**2018**	2017	2016
Provision for losses	**$ 3,538**	$ 3,895	$ 6,741

For the year ended June 30, 2018, the provision for loan losses was $3.5 million, a 10.3% decrease from $3.9 million in 2017. For the year ended June 30, 2017, the provision for loan losses was $3.9 million, a 41.8% decrease from $6.7 million in 2016.

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

Noninterest Revenue

The following table displays the categories of noninterest revenue.

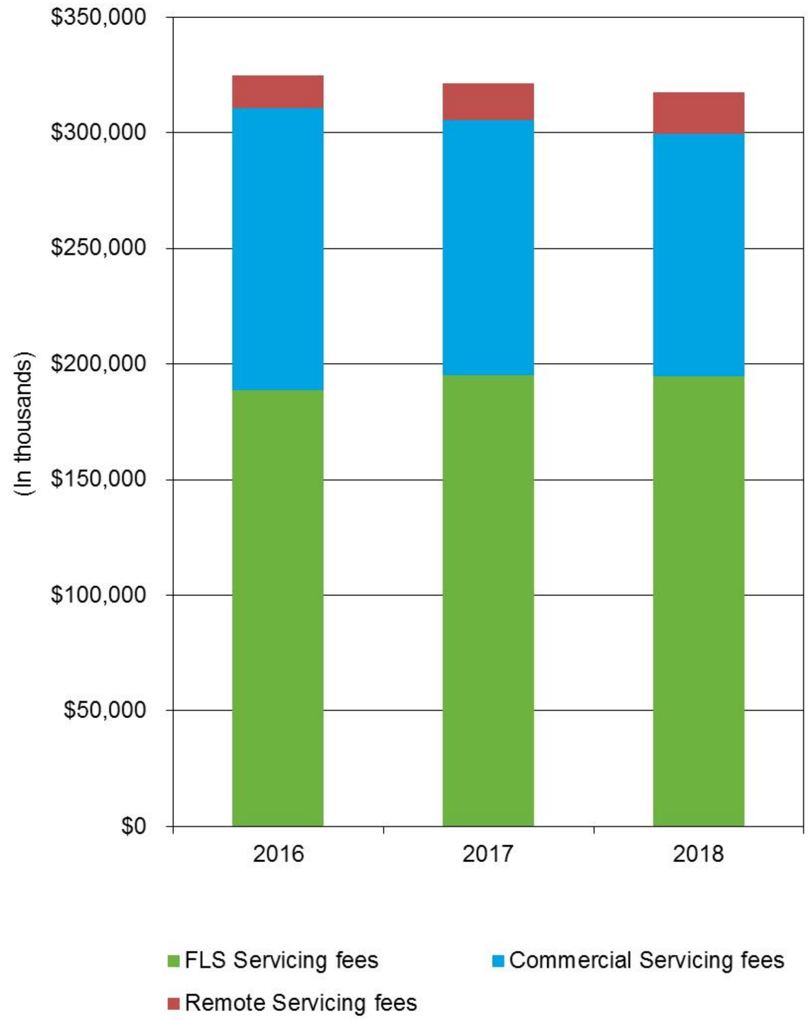
(Dollars in thousands)

For the years ended June 30,	**2018**	2017	2016
Servicing fees	**$ 317,560**	$ 321,350	$ 324,664
Retention of collections on defaulted loans, net	**146,146**	174,538	170,809
Federal fees	**15,619**	17,275	18,922
Other	**5,295**	5,868	1,472
Total noninterest revenue	**$ 484,620**	$ 519,031	$ 515,867

For the year ended June 30, 2018, total noninterest revenue was $484.6 million, a 6.6% decrease from $519.0 million in 2017. For the year ended June 30, 2017, total noninterest revenue was $519.0 million, a 0.6% increase from $515.9 million in 2016.

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

Servicing Fees
Years ended June 30



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

Total Servicing Fees

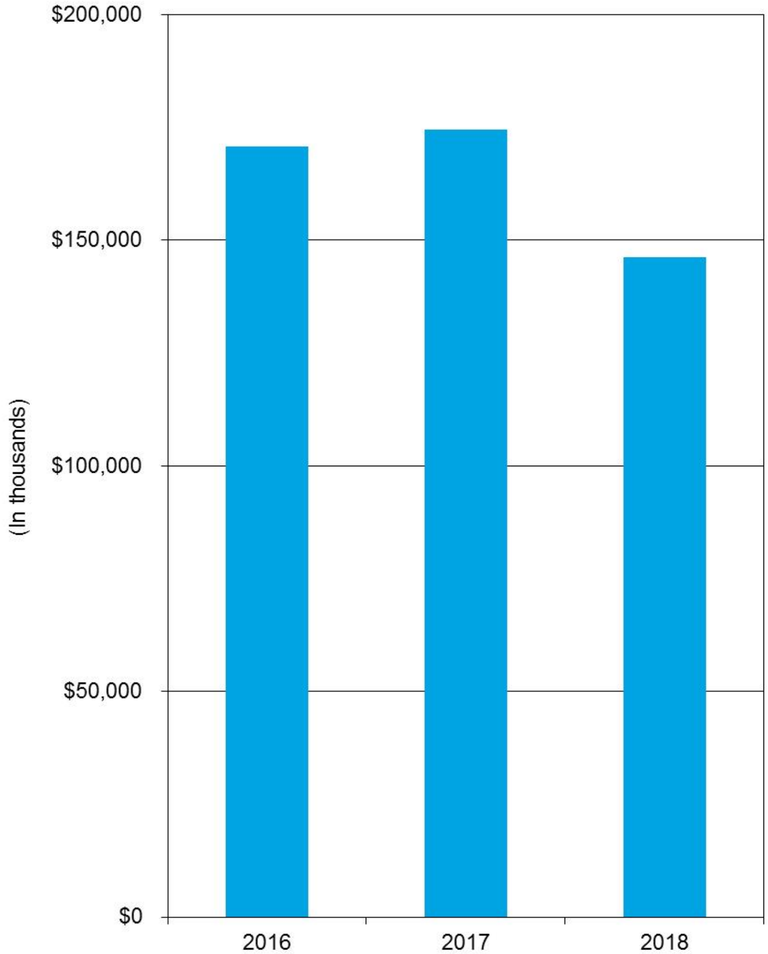
For the year ended June 30, 2018, total servicing fees were $317.6 million, a 1.2% decrease from $321.4 million in 2017. The average balance of third party loans serviced on our systems increased to $406.5 billion or 9.1% in 2018 from $372.6 billion in 2017.

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

For the years ended June 30, 2018 and 2017, the decreases in total servicing fees were due to decreases in the Commercial Servicing loan portfolio, which was partially offset by increases in the Remote Servicing portfolio.

Retention of Collections on Defaulted Loans, net

For the years ended June 30



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

For the year ended June 30, 2018, the retention of collections on defaulted loans, net, was $146.1 million, a 16.3% decrease from $174.5 million in 2017. For the year ended June 30, 2018, total collections on defaulted loans, was $0.9 billion, a 19.3% decrease from $1.1 billion in 2017. The decrease in the retention of collections on defaulted loans, net, was due to a decrease in the total volume of collections on rehabilitated student loans.

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

Operating Expenses

The following tables display our major categories of operating expenses.

(Dollars in thousands)

For the years ended June 30,	2018		2017		2016	
Personnel and benefits	**$ 320,774**	**57.2%**	$ 319,622	56.0%	$ 305,489	57.8%
Professional services	**96,801**	**17.3%**	109,296	19.1%	97,073	18.4%
Information technology related expenses	**62,985**	**11.2%**	59,627	10.5%	50,828	9.6%
Mail services	**24,380**	**4.4%**	27,873	4.9%	32,588	6.2%
Depreciation	**20,045**	**3.6%**	16,758	2.9%	13,770	2.6%
Other	**35,323**	**6.3%**	37,747	6.6%	28,867	5.4%
Total operating expenses	**$ 560,308**	**100.0%**	$ 570,923	100.0%	$ 528,615	100.0%

For the year ended June 30, 2018, operating expenses were $560.3 million, a 1.9% decrease from $570.9 million in 2017. For the year ended June 30, 2017, operating expenses were $570.9 million, an 8.0% increase from $528.6 million in 2016. In the sections that follow, we discuss changes in personnel and benefits, professional services, information technology related expenses, mail services and other expenses.

Personnel and Benefits

The following tables display personnel and benefits expenses:

(Dollars in thousands)

For the years ended June 30,	2018		2017		2016	
Compensation	**$ 165,658**	**51.6%**	$ 168,869	52.8%	$ 171,333	56.1%
Pension expense	**66,039**	**20.6%**	79,651	24.9%	65,807	21.5%
Health care benefits for employees and retirees	**35,128**	**11.0%**	37,913	11.9%	37,790	12.4%
Independent contractor fees	**23,657**	**7.4%**	20,144	6.3%	16,019	5.2%
Other postemployment benefits expense	**20,693**	**6.4%**	4,692	1.5%	4,650	1.5%
Employer's share of Social Security	**12,271**	**3.8%**	12,270	3.7%	12,487	4.1%
Capitalized software development costs	**(4,194)**	**(1.3%)**	(5,727)	(1.7%)	(4,301)	(1.4%)
Other	**1,522**	**0.5%**	1,810	0.6%	1,704	0.6%
Total personnel and benefits	**$ 320,774**	**100.0%**	$ 319,622	100.0%	$ 305,489	100.0%

For the year ended June 30, 2018, personnel and benefits costs were $320.8 million, a 0.4% increase from $319.6 million in 2017. For the year ended June 30, 2017, personnel and benefits costs were $319.6 million, a 4.6% increase from $305.5 million in 2016.

Pension expense

For the year ended June 30, 2018, pension expense was $66.0 million, a 17.2% decrease from $79.7 million in 2017. For the year ended June 30, 2017, pension expense was $79.7 million, a 21.1% increase from $65.8 million in 2016. For the years ended June 30, 2018 and 2017, the changes in pension expense were due to changes in the total pension liability of the pension plan and our covered employee payroll, which these changes directly affected our proportionate share of collective pension expense. **See Note 10 – *Retirement and Other Postemployment Benefits***, subtopic ***SERS GASB 68 Valuation*** and the **Required Supplementary Information** section, subtopic ***Pension*** for more details on our proportionate share of collective pension expense and our covered employee payroll.

Independent Contractor Fees

For the year ended June 30, 2018, independent contractor fees were $23.7 million, a 17.9% increase from $20.1 million in 2017. For the year ended June 30, 2017, independent contractor fees were $20.1 million, a 25.6% increase from $16.0 million in 2016. The increases in independent contractor fees were related to information technology and internal audit activities.

Other Postemployment Benefits ("OPEB") expense

For the year ended June 30, 2018, OPEB expense was $20.7 million, a 340.4% increase from $4.7 million in 2017. For the year ended June 30, 2018, the increase in OPEB expense was due to the adoption and implementation of GASB Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* ("GASB 75"). See **Note 4 – *Change in Accounting Principle*** and **Note 10 – *Retirement and Other Postemployment Benefits***, subtopic ***OPEB GASB 75 Valuation*** and the **Required Supplementary Information** section, subtopic ***OPEB*** for more details on our total OPEB expense.

For the years ended June 30, 2017 and 2016, OPEB expense was $4.7 million.

Professional Services

For the year ended June 30, 2018, professional services expenses were $96.8 million, an 11.4% decrease from $109.3 million in 2017. The decrease in professional services expenses were mainly due to decreases in third party collection agency fees and consulting fees, which were partially offset by increases in our outsourced processing functions to third party vendors and legal fees associated with our on-going litigation.

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

Information technology related expenses

For the year ended June 30, 2018, information technology related expenses were $63.0 million, a 5.7% increase from $59.6 million in 2017. The increase in information technology related expenses was due to increases in information technology equipment, software maintenance, and software licenses and rentals.

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

Mail Services

For the year ended June 30, 2018, mail services expenses were $24.4 million, a 12.5% decrease from $27.9 million in 2017. For the year ended June 30, 2017, mail services expenses were $27.9 million, a 14.4% decrease from $32.6 million in 2016. The reduction in mail services expenses were a result of the increased usage of electronic correspondence.

Other

For the year ended June 30, 2018, other expenses were $35.3 million, a 6.4% decrease from $37.7 million in 2017. The decrease in other expenses was mainly due to the prior period in which we incurred $8.2 million of bond issuance costs associated with the PHEAA Student Loan Trusts 2016-1 and 2016-2 bond issuances. This decrease was partially offset by a $2.5 million increase in telephone expense associated with our toll-free 800 lines and $3.3 million of various other expenses.

For the year ended June 30, 2017, other expenses were $37.7 million, a 30.4% increase from $28.9 million in 2016. The increase in other expenses was mainly due to an increase in bond issuance costs associated with the PHEAA Student Loan Trusts 2016-1 and 2016-2 bond issuances. This increase was partially offset by a reduction in the net realizable value adjustment in amounts due from the Federal Fund.

Changes in Net Position

The following table shows the changes in net position:

(Dollars in thousands)

For the years ended June 30,	**2018**	2017	2016
Operating income	**$ 21,478**	$ 65,757	$ 96,812
Commonwealth of Pennsylvania grants	**333,560**	334,695	365,359
Federal grants	**1,598**	1,608	1,587
Grants and other financial aid, net of refunds	**(439,484)**	(466,739)	(466,439)
Grant funds returned to the Commonwealth	**-**	-	(49,628)
Total grants and financial aid	**(104,326)**	(130,436)	(149,121)
Changes in net position	**$ (82,848)**	$ (64,679)	$ (52,309)

Commonwealth of Pennsylvania Grants

For the year ended June 30, 2018, Commonwealth of Pennsylvania grants were $333.6 million, a 0.3% decrease from $334.7 million in 2017. The decrease in the Commonwealth of Pennsylvania grants was due to the timing of allocated grant funding received from the Commonwealth.

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

Grants and Other Financial Aid Activity, net

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

(Dollars in thousands)

For the years ended June 30,	**2018**	2017	2016
Pennsylvania State Grant Program, net of refunds	**$ 357,606**	$384,669	$392,902
Institutional Assistance Grant Program, net of refunds	**25,742**	26,285	24,495
Matching Funds Program, net of refunds	**12,504**	11,813	11,566
Pennsylvania National Guard Education Assistance Program, net of refunds	**11,278**	13,140	12,488
Pennsylvania Distance Education Program, net of refunds	**10,339**	12,974	10,323
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program, net of refunds	**6,141**	6,990	4,886
Pennsylvania Ready to Succeed Scholarship Program, net of refunds	**4,963**	5,077	5,019
Primary Healthcare Loan Forgiveness, net of refunds	**4,492**	209	241
Higher education for the disadvantaged, net of refunds	**2,236**	2,006	2,283
Other Programs, net of refunds	**4,183**	3,576	2,236
Total grants and other financial aid, net	**$ 439,484**	$466,739	$466,439

For the year ended June 30, 2018, grants and other financial aid, net, were $439.5 million, a 5.8% decrease from $466.7 million during 2017. For the year ended June 30, 2017, grants and other financial aid, net, were $466.7 million, a 0.1% increase from $466.4 million during 2016. The changes in grants and other financial aid, net of refunds, were primarily due to the timing of funds disbursed from various grant programs.

Student Loan Receivables, net

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

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
FFEL student loans:			
Consolidation	**$ 3,674,455**	$ 4,057,477	$ 4,705,793
Stafford	**816,667**	849,572	1,074,457
PLUS	**66,904**	75,457	104,978
SLS	**711**	812	987
Total FFEL student loans	**4,558,737**	4,983,318	5,886,215
Private and HEAL student loans:			
Private	**16,531**	20,133	28,789
HEAL	**11,920**	19,103	27,974
Total private and HEAL student loans	**28,451**	39,236	56,763
Total student loans receivable	**4,587,188**	5,022,554	5,942,978
Unamortized student loan purchase premium	**3,431**	5,559	8,203
Unamortized student loan purchase discount	**(9,240)**	(8,308)	(11,913)
Allowance for loan losses	**(6,131)**	(6,646)	(21,229)
Total student loan receivables, net	**$ 4,575,248**	$ 5,013,159	$ 5,918,039

As of June 30, 2018, student loan receivables, net, were $4.6 billion, an 8.0% decrease from $5.0 billion in 2017. As of June 30, 2017, student loan receivables, net, were $5.0 billion, a 15.3% decrease from $5.9 billion in 2016.

As of June 30, 2018 and 2017, the decrease in student loan receivables, net, was mainly due to borrower payments, claim and consolidation payoffs.

Delinquencies have the potential to adversely affect earnings through increased collection costs and charge-offs/write-offs. The June 30, 2018 table that follows presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $0.3 million of student loans categorized as non-performing, $2.4 million of student loans categorized as uninsured, $0.1 million of student loans with credit balances and $0.2 million of student loan payments in-process.

(Dollars in thousands)

As of June 30, 2018	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	$ 2,834		$ 10		$ 2,844	
Loans in deferment and forbearance:						
Deferment	256,258		897		257,155	
Forbearance	400,244		298		400,542	
Total loans in-school/in-grace, and deferment and forbearance	$ 659,336		$ 1,205		$ 660,541	
Loans in repayment:						
Current	$ 3,476,770	89.2%	$ 25,381	94.2%	$ 3,502,151	89.3%
31 – 60 days	119,281	3.1%	446	1.6%	119,727	3.1%
61 – 90 days	66,331	1.7%	338	1.3%	66,669	1.6%
91 – 120 days	52,436	1.3%	154	0.6%	52,590	1.3%
121 – 180 days	76,476	2.0%	73	0.3%	76,549	2.0%
181 – 270 days	67,259	1.7%	47	0.2%	67,306	1.7%
271 days or greater	22,230	0.6%	129	0.4%	22,359	0.6%
Claims filed not paid	16,200	0.4%	389	1.4%	16,589	0.4%
Total loans in repayment	$ 3,896,983	100.0%	$ 26,957	100.0%	$ 3,923,940	100.0%

The June 30, 2017 table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $0.1 million of student loans categorized as non-performing, $2.6 million of student loans categorized as uninsured, $0.1 million of student loans with credit balances and $0.1 million of student loan payments in-process.

(Dollars in thousands)

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

Allowance for Loan Losses

Allowances for potential losses on our student loans can result from the risk sharing on defaulted and uninsured loans. We base the allowances amounts 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. As of June 30, 2018, we believe the allowance for loan losses is adequate to cover the inherent losses on our student loan portfolio.

We do separate calculations for FFEL and non-FFEL loans, both of which are combined and reported in "Student loans receivable, net" in the Statements of Net Position. The individual tables that follow detail the activity within the FFEL and non-FFEL student loan portfolios. For additional information, please refer to **Note 7 - Student Loans Receivable, net**, and the MD&A section titled **"Net Interest Revenue after the Provision for Loan Losses"**.

FFEL Program Loans

The allowance for loan losses-FFEL program loans represents our estimate of the losses related to the risk sharing on FFEL program loans only.

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Balance at beginning of period	**$ 6,295**	$ 16,599	$ 15,100
Provision for losses	**3,323**	3,228	7,882
Charge-offs/Write-offs	**(3,842)**	(13,532)	(6,383)
Balance at end of period	**$ 5,776**	$ 6,295	$ 16,599
Ending balance of student loans	**$ 4,558,737**	$ 4,983,318	$ 5,886,215
Allowance as a percentage of ending balance of student loans	**0.13%**	0.13%	0.28%

Other Program Loans (Non-FFEL)

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

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Balance at beginning of period	**$ 351**	$ 4,630	$ 5,771
Provision for losses	**215**	667	(1,141)
Charge-offs/Write-offs	**(211)**	(4,946)	-
Balance at end of period	**$ 355**	$ 351	$ 4,630
Ending balance of student loans	**$ 28,451**	$ 39,236	$ 56,763
Allowance as a percentage of ending balance of student loans	**1.25%**	0.89%	8.16%

Debt Activity and Capital Assets

Debt Activity

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

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Deferred outflow of resources:			
Deferred loss on bond refundings	**$ 2,345**	$ 841	$ 1,299
Current liabilities:			
Student loan financings	**240,000**	200,000	938,213
Other financings	**4,230**	4,055	3,895
Long-term liabilities:			
Student loan financings, net	**4,108,779**	4,762,797	4,751,841
Other financings, net	**21,377**	26,099	30,734
Deferred inflow of resources:			
Deferred gain on bond refundings	**$ 42,007**	$ 82,247	$ 134,067

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

As of June 30, 2018, our outstanding debt, excluding our blended component units, the deferred gain and loss on bond refundings, and premiums and discounts on bonds, amounted to $776.4 million, which was below the 20% threshold mentioned above. The blended component units are excluded from this threshold, because their debt was not issued by PHEAA. As of June 30, 2018, the outstanding debt of our blended component units was $3.6 billion, which was related to the student loan trusts. See **Note 14 – Blended Component Units** for more details on the student loan trusts.

The following tables show the proceeds and repayment activity of our debt.

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Capital market activity			
Proceeds from issuing student loan floating rate notes	**$ -**	$ 925,568	$ -
Repayment of student loan floating rate notes	**(741,341)**	(873,723)	(853,142)
Repayment of student loan auction rate security bonds	**(164,359)**	(45,050)	(50,200)
Student loan financing activity			
Proceeds from student loan financings	**$ 461,932**	$ -	$ -
Repayment of student loan financings	**(175,946)**	(738,213)	(165,566)
Other financing activity			
Repayment of capital acquisition refunding bonds	**$ (4,055)**	$ (3,895)	$ (3,745)

2018 Debt Activity

Capital Market Activity & Student Loan Financing Activity

For the year ended June 30, 2018, the $741.3 million repayment of student loan floating rate notes were due to required debt payments. The $164.4 million repayment of student loan auction rate security bonds was due to the redemption of the PHEAA Student Loan Trust I auction rate security bonds and required debt payments.

For the year ended June 30, 2018, the $461.9 million of proceeds from the student loan financings were due to borrowings from the PHEAA Warehouse Facility Trust 2013-1 and our student loan financing facility, and were used to redeem the PHEAA Student Loan Trust I auction rate security bonds and purchase rehabilitated student loans. The $175.9 million repayment of student loan financings were due to required debt payments.

Other Financing Activity

For the year ended June 30, 2018, the $4.1 million repayment of capital acquisition refunding bonds were due to required principal and interest payments on the Capital Acquisition Refunding Bonds, Series of 2012.

2017 Debt Activity

Capital Market Activity & Student Loan Financing Activity

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

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

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

Other Financing Activity

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

See **Note 9 – Notes and Bonds Payable and Other Financings** for more details on the debt activity.

Capital Assets

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

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Land	**$ 8,038**	$ 8,038	$ 8,038
Software, net (purchased and developed)	**38,110**	30,326	21,027
Buildings and improvements, net	**29,630**	31,664	33,082
IT equipment, net	**10,648**	12,018	9,824
Other, net	**4,599**	6,192	7,116
Total capital assets, net	**$ 91,025**	$ 88,238	$ 79,087

As of June 30, 2018, capital assets, net of accumulated depreciation and amortization, were $91.0 million, a 3.2% increase from $88.2 million as of June 30, 2017. The increase in capital assets, net of accumulated depreciation and amortization, was mainly due to the purchase of software.

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

Net Position

The following table shows our restricted and unrestricted net position.

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Net investment in capital assets	**$ 91,025**	$ 88,238	$ 79,087
Restricted for debt service	**341,848**	305,780	310,324
Restricted for financial aid grant programs	**33,035**	29,305	52,079
Unrestricted	**(244,392)**	263,709	310,221
Total net position	**$ 221,516**	$687,032	$751,711

Net investment in capital assets

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

As of June 30, 2018, the net investment in capital assets was $91.0 million, a 3.2% increase from $88.2 million as of June 30, 2017. The increase in net investment in capital assets was mainly due to the purchase of software.

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

Restricted for debt service

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

As of June 30, 2018, we had net position restricted for debt service of $341.8 million, an 11.8% increase from $305.8 million as of June 30, 2017. The increase in net position restricted for debt service was due to $55.7 million of operating income restricted for debt service, which was partially offset by $19.7 million of transfers to unrestricted net position.

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

See **Note 13 - Segment Information** for more details.

Restricted for financial aid grant programs

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

As of June 30, 2018, we had net position restricted for financial aid grant programs of $33.0 million, a 12.6% increase from $29.3 million as of June 30, 2017. The increase in net position restricted for financial aid grant programs was mainly due to $1.5 million of operating income restricted for financial aid grant programs, $335.2 million of grant funding received from the Commonwealth and the federal government, and $90.0 million of transfers from unrestricted net position (Pennsylvania State Grant Fund and Agency Operating Fund), which were offset by $423.0 million of grant disbursements, net of refunds.

As of June 30, 2017, we had net position restricted for financial aid grant programs of $29.3 million, a 43.8% decrease from $52.1 million as of June 30, 2016. The decrease in net position restricted for financial aid grant programs was mainly due to $0.7 million of operating income restricted for financial aid grant programs, $336.2 million of grant funding received from the Commonwealth and the federal government, and $87.0 million of transfers from unrestricted net position (Pennsylvania State Grant Fund), which were offset by $446.7 million of grant disbursements, net of refunds.

Unrestricted

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

As of June 30, 2018, we had unrestricted net position of a negative $244.4 million, a 192.7% decrease from $263.7 million as of June 30, 2017. The decrease in unrestricted net position was due to an unrestricted operating loss of $35.8 million, $382.7 million for the cumulative effect of adopting GASB 75, $90.0 million of transfers to net position restricted for financial aid grant programs (Pennsylvania State Grant Program, Cheyney University and Primary Healthcare Loan Forgiveness), $16.5 million of net grant disbursements, and $2.8 million of funds transferred to net investment in capital assets, which were offset by $19.7 million of funds transferred from net position restricted for debt service.

As of June 30, 2017, we had unrestricted net position of $263.7 million, a 15.0% decrease from $310.2 million as of June 30, 2016. The decrease in unrestricted net position was due to $68.7 million of funds transferred from net position restricted for debt service, and unrestricted operating income of $0.8 million, which was offset by $87.0 million of transfers to net position restricted for financial aid grant programs, $20.0 million of net grant disbursements, and $9.1 million of funds transferred to net investment in capital assets.

Federal Student Loan Reserve Fund (Federal Fund)

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

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

(Dollars in thousands)

As of June 30,	**2018**	2017	2016
Additions			
Reinsurance from the U.S. Department of Education	**$ 857,534**	$ 937,958	$ 1,010,666
Collections on defaulted loans	**734,884**	978,340	1,023,342
Net appreciation in the fair value of investments	**219**	144	79
Total additions	**1,592,637**	1,916,442	2,034,087
Deductions			
Purchases of defaulted loans from lenders	**855,416**	934,470	1,023,336
Reimbursement to U.S. Department of Education for federal share of defaulted loans collections	**565,154**	743,708	779,537
Reimbursement to PHEAA for our retention of defaulted loans collections	**154,555**	203,123	207,316
Default aversion fees, net	**4,908**	7,920	9,579
Total deductions	**1,580,033**	1,889,221	2,019,768
Net increase	**12,604**	27,221	14,319
Net liabilities, beginning of period	**(145,278)**	(172,499)	(186,818)
Net liabilities, end of period	**$ (132,674)**	$ (145,278)	$ (172,499)

For the year ended June 30, 2018, reinsurance from ED was $857.5 million, an 8.6% decrease from $938.0 million in 2017. For the year ended June 30, 2018, reimbursement to ED for the federal share of defaulted loans collections was $565.2 million, a 24.0% decrease from $743.7 million in 2017. The changes in the reinsurance from ED and the reimbursement to ED were due to the decline in the collections on defaulted loans.

For the year ended June 30, 2017, reinsurance from ED was $938.0 million, a 7.1% decrease from $1.0 billion in 2016. For the year ended June 30, 2017, reimbursement to ED for the federal share of defaulted loans collections was $743.7 million, a 4.6% decrease from $779.5 million in 2016. The changes in the reinsurance from ED and the reimbursement to ED were due to the decline in the collections on defaulted loans.

For the year ended June 30, 2018, collections on defaulted loans were $734.9 million, a 24.9% decrease from $978.3 million in 2017. For the year ended June 30, 2018, purchases of defaulted loans were $855.4 million, an 8.5% decrease from $934.5 million in 2017. The changes in the collections on and purchases of defaulted loans were due to the decline in the total volume of rehabilitation loans as more borrowers enter into income based repayment options.

For the year ended June 30, 2017, collections on defaulted loans were $978.3 million, a 2.2% decrease from $1.0 billion in 2016. For the year ended June 30, 2017, purchases of defaulted loans were $934.5 million, an 6.6% decrease from $1.0 billion in 2016. The changes in the collections on and purchases of defaulted loans were due to the decline in the total volume of rehabilitation loans as more borrowers enter into income based repayment options.

Under the Higher Education Act of 1965, as amended, Section 428(c)(9)(A), we are required to maintain a current minimum reserve level of at least 0.25% of the total attributable amount of all outstanding loans guaranteed. 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.

FSA calculates the minimum Federal Reserve Ratio without adding allowances and other non-cash charges back to the Federal Fund. FSA's calculation of the minimum Federal Reserve Ratio is as follows: Federal Fund Balance (Form 2000 AR26) divided by Original Principal Outstanding.

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

(Dollars in thousands)	**As of June 30, 2018**	As of September 30, 2017
Generally accepted accounting principles – net assets	**$ (132,674)**	$ (142,163)
Default aversion fees payable to PHEAA, but not transferred from the Federal Fund to PHEAA	**190,960**	191,805
Gain contingency – collections complement on future default collections	**69,540**	68,181
Gain contingency – default aversion fee rebate payable from PHEAA to the Federal Fund	**9,008**	8,404
Regulatory net assets	**$ 136,834**	$ 126,227
Original principal outstanding	**$ 23,284,875**	$ 25,448,051
Federal reserve ratio	**0.59%**	0.50%
Minimum federal reserve ratio	**0.25%**	0.25%

See **Note 5 – 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.

Phone – (717) 720-7890
Fax – (717) 720-3923
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September 20, 2018

(Dollars in thousands)

	2018	2017
Operating revenues and expenses		
Interest revenue		
Student loans, net	**$ 157,952**	$143,789
Investments	**16,051**	15,961
Total interest revenue	**174,003**	159,750
Interest expense		
Student loan financings, net	**72,951**	37,781
Other financings, net	**348**	425
Total interest expense	**73,299**	38,206
Net interest revenue	**100,704**	121,544
Provision for loan losses	**(3,538)**	(3,895)
Net interest revenue after provision for loan losses	**97,166**	117,649
Noninterest revenue		
Servicing fees	**317,560**	321,350
Retention of collections on defaulted loans, net	**146,146**	174,538
Federal fees	**15,619**	17,275
Other	**5,295**	5,868
Total noninterest revenue	**484,620**	519,031
Operating revenues	**581,786**	636,680
Operating expenses		
Personnel & benefits	**320,774**	319,622
Professional services	**96,801**	109,296
Information technology related expenses	**62,985**	59,627
Mail services	**24,380**	27,873
Depreciation	**20,045**	16,758
Other	**35,323**	37,747
Total operating expenses	**560,308**	570,923
Operating income	**21,478**	65,757
Grants and financial aid		
Commonwealth of Pennsylvania grants	**333,560**	334,695
Federal grants	**1,598**	1,608
Grants and other financial aid, net of refunds	**(439,484)**	(466,739)
Total grants and financial aid, net	**(104,326)**	(130,436)
Changes in net position	**(82,848)**	(64,679)
Net position, beginning of period (**restated**)	**304,364**	751,711
Net position, end of period	**$ 221,516**	$ 687,032

See accompanying notes to the financial statements.

(Dollars in thousands)

	2018	2017
Current assets:		
Cash and cash equivalents	**$ 64,452**	$ 126,142
Restricted cash and cash equivalents	**150,745**	312,787
Restricted cash and cash equivalents – due to customers	**78,015**	84,592
Investments	**424,641**	544,638
Restricted investments	**31,822**	28,999
Student loans receivable	**752,702**	788,882
Interest income receivable	**94,585**	72,897
Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net	**69,539**	60,657
Due from Federal Student Loan Reserve Fund, net	**11,287**	15,012
Other assets	**62,076**	44,556
Total current assets	**1,739,864**	2,079,162
Long-term assets:		
Student loans receivable, net	**3,822,546**	4,224,277
Capital assets, net	**91,025**	88,238
Total long-term assets	**3,913,571**	4,312,515
Total assets	**5,653,435**	6,391,677
Deferred outflow of resources:		
Deferred outflows of resources related to pensions	**76,917**	133,969
Deferred outflows of resources related to other postemployment benefits	**4,062**	-
Deferred loss on bond refundings	**2,345**	841
Total deferred outflow of resources	**83,324**	134,810
Current liabilities:		
Accounts payable and accrued expenses	**154,107**	193,268
Student loan financings	**240,000**	200,000
Amounts related to the Federal Student Loan Reserve Fund	**69,539**	60,657
Other financings	**4,230**	4,055
Total current liabilities	**467,876**	457,980
Long-term liabilities:		
Student loan financings, net	**4,108,779**	4,762,797
Net pension liability	**413,878**	474,743
Other postemployment benefit liability	**357,062**	-
Other financings, net	**21,377**	26,099
Accrued expenses	**23,255**	23,730
Total long-term liabilities	**4,924,351**	5,287,369
Total liabilities	**5,392,227**	5,745,349
Deferred inflow of resources:		
Deferred gain on bond refundings	**42,007**	82,247
Deferred inflows of resources related to pensions	**34,549**	11,601
Deferred inflows of resources related to other postemployment benefits	**46,299**	-
Deferred gain on sales leaseback	**161**	258
Total deferred inflow of resources	**123,016**	94,106
Net position		
Net invested in capital assets	**91,025**	88,238
Restricted for debt service	**341,848**	305,780
Restricted for financial aid grant programs	**33,035**	29,305
Unrestricted	**(244,392)**	263,709
Total net position	**$ 221,516**	$ 687,032

See accompanying notes to the financial statements.

(Dollars in thousands)

	2018	2017
Cash flows from operating activities		
Interest received on student loans	**$ 65,684**	$ 80,058
Principal received on student loans	**824,140**	933,451
Student loan purchases	**(811,452)**	(812,138)
Student loan sales, including net gains and losses	**493,645**	836,309
Servicing fees	**301,149**	343,111
Retention of collections on defaulted loans	**149,519**	196,632
Federal fees	**16,045**	17,708
Default aversion fee rebates	**542**	(1,247)
Other	**273**	351
Payment of operating expenses	**(537,301)**	(490,405)
Net cash provided by operating activities	**502,244**	1,103,830
Cash flows from noncapital financing activities		
Proceeds from issuance of noncapital debt	**461,932**	925,568
Principal paid on noncapital debt	**(1,085,701)**	(1,660,881)
Interest paid on noncapital debt	**(107,740)**	(85,431)
Bond issuance costs	**(333)**	(8,164)
Commonwealth of Pennsylvania grants received	**333,560**	334,695
Federal grants received	**1,598**	1,608
Grants and financial aid paid	**(439,484)**	(466,739)
Net cash used for noncapital financing activities	**(836,168)**	(959,344)
Cash flows from capital and related financing activities		
Purchases of capital assets and development of software, net of disposals	**(22,931)**	(26,005)
Net cash used for capital and related financing activities	**(22,931)**	(26,005)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	**776,163**	813,383
Purchases of investments	**(656,413)**	(797,191)
Interest received on investments	**13,373**	8,355
Net cash provided by investing activities	**133,123**	24,547
Net change in cash and cash equivalents (including restricted cash)	**(223,732)**	143,028
Cash and cash equivalents (including restricted cash), beginning of period	**438,929**	295,901
Cash and cash equivalents (including restricted cash), end of period	**$ 215,197**	$ 438,929

(continued)

(Dollars in thousands)

	2018	2017
Reconciliation of operating income to net cash provided by operating activities		
Operating income	**$ 21,478**	$ 65,757
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	**20,045**	16,758
Interest paid on noncapital debt	**107,740**	85,432
Investment interest	**(16,051)**	(15,961)
Bond issuance costs	**333**	8,164
Pension expense valuation adjustment	**19,135**	37,657
Other postemployment benefit expense valuation adjustment	**16,631**	-
Amortization of premium on loan purchases	**2,128**	2,644
Amortization of gain and loss on bond refunding	**(39,435)**	(51,362)
Amortization of discount on bonds payable	**3,387**	4,161
Amortization of premium on other financings	**(491)**	(580)
Changes in assets and liabilities:		
(Increase) decrease in interest income receivable	**(21,585)**	5,207
Decrease in student loans receivable	**435,783**	902,236
Decrease in amounts due from Federal Student Loan Reserve Fund	**3,725**	22,062
(Increase) decrease in other assets	**(17,520)**	22,030
Decrease in accounts payable and accrued expenses	**(33,059)**	(375)
Total adjustments	**480,766**	1,038,073
Net cash provided by operating activities	**$ 502,244**	$1,103,830

See accompanying notes to the financial statements.

Note 1 – About PHEAA

Organization

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

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

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

Blended Component Units

PHEAA Student Loan Foundation, Inc.

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

PHEAA Student Loan Trusts

We have various student loan trusts that are statutory trusts formed under the laws of the State of Delaware. The principal purposes of the student loan trusts are to securitize student loans and related assets and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the student loan trusts generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. See **Note 14 - Blended Component Units** for more details on the PHEAA Student Loan Trusts.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Accounting

The basic financial statements have been prepared in conformity with generally accepted accounting principles ("GAAP") in the United States applicable to governments. The Governmental Accounting Standards Board

("GASB") establishes accounting and financial reporting requirements for governments. We prepared our financial statements based on the governmental proprietary fund (enterprise fund) reporting concept, which follows the economic resources measurement focus and accrual basis of accounting. The proprietary fund financial reporting concept focuses on the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows.

Use of Estimates

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

Cash Equivalents

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

Restricted Cash and Investments

Restricted cash and investments include cash received from the Commonwealth for allocated grant funding, and cash and investments of bond proceeds held by a trustee and restricted by the provision of the bond indentures and financing agreements. We consider these amounts restricted and they cannot be disbursed for any other purpose.

Investments

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

Pools 998 and 999 each have their own distinct investment strategies, goals, and holdings that reflect the differing needs of Commonwealth funds for income, cash flows, and risk tolerance. Pool 998 is a less liquid vehicle that allows for investment in assets that offer potentially higher returns with commensurate risk. Pool 999 is a highly liquid vehicle that consists of short-term fixed income securities and cash, which provide a high degree of liquidity and security but only modest returns. The Treasury Department provides us information on the net asset value for Pools 998 and 999 and we report the amounts invested in these pools at fair value.

Student Loans Receivable, net

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

Allowance for loan losses

We estimated and established an allowance for loan losses based upon our ongoing evaluation of the student loan portfolios, past and anticipated loss experience and the amount and quality of the student loans. 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.

Federal Family Education Loan ("FFEL") Program Loans

The allowance for loan losses-FFEL program loans represents our estimate of the losses related to the risk sharing on FFEL program loans only. We record a provision for loan losses on FFEL program loans and FFEL program loans in a cure status as follows:

- FFEL program loans - The allowance for loan losses represents our estimate of the losses related to the risk sharing on the FFEL program loans and it is a weighted average calculation that considers the following guarantee rates:
  - 100% of the unpaid principal balance of each loan disbursed before October 1, 1993;
  - Not more than 98% of the unpaid principal balance of each loan disbursed on or after October 1, 1993 and before July 1, 2006; and
  - Not more than 97% of the unpaid principal balance of each loan disbursed on or after July 1, 2006 and before July 1, 2010. Student loans were no longer originated under the FFEL program on or after July 1, 2010.

- Cure loans – We consider a loan to be in "cure" status when a due diligence violation has occurred on a PHEAA owned loan and the servicer is attempting to correct or "cure" the loan. When a student loan enters a cure status, the guarantor will not guarantee the student loan and reimburse the lender for the outstanding principal and interest of the loan if the borrower defaults on the student loan while in a cure status. A loan can become incurable after three years of unsuccessfully trying to cure the loan, if a loan does not pay-off within the defined terms (i.e. 120 months for a 10 year Stafford loan), or due to an origination error. We record a provision for loan losses on any loans that have been in a cure status for greater than 24 months, and any loans considered incurable.

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

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

Other Program Loans (Non-FFEL)

The allowance for loan losses-other program loans (Non-FFEL) represents our estimate of the losses related to the risk associated with non-FFEL program loans, such as private loans. We record a provision for loan losses on "other program loans" as follows:

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

when the student loans are greater than 120 days delinquent, when student loans are expected to default, and when student loans are non-performing.

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

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

Capital Assets, net

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

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

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

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

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

Deferred Gain (Loss) on Bond Refundings

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

Compensated Absences

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

Revenue Recognition

Student loan interest revenue, net

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

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

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

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.

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.

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

Servicing fees

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

Retention of Collections on Defaulted Loans, net

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

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

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

Federal Fees

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

Student Loan Financings and Other Financings Interest Expense

We record student loan financings and other financings interest expense based upon contractual interest rates. We report student loan financings and other financings interest expense net of the amortization of bond discounts and premiums and the amortization of deferred gains and losses on bond refundings.

Operating Revenues and Expenses

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

Commonwealth of Pennsylvania and Federal Grant Revenues

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

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

Elimination of Intra-Entity Activity

The PHEAA Student loan Trust I, the PHEAA Student Loan Trust 2011-1, the PHEAA Student Loan Trust 2012-1, the PHEAA Student Loan Trust 2013-1, the PHEAA Student Loan Trust 2013-2, the PHEAA Student Loan Trust 2013-3, the PHEAA Student Loan Trust 2014-1, the PHEAA Student Loan Trust 2014-2, the PHEAA Student Loan Trust 2014-3, the PHEAA Student Loan Trust 2015-1, the PHEAA Student Loan Trust 2016-1, the PHEAA Student Loan Trust 2016-2 and the PHEAA Warehouse Facility Trust 2013-1 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.

Note 3 – Recently Issued GASB Pronouncements

During 2017, the GASB issued Statement No. 85 – *Omnibus 2017* ("GASB 85"). The objective of this Statement is to address practice issues that were identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB)). The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged. On July 1, 2017, we adopted and implemented GASB 85, and as of June 30, 2018, there was no material impact to the financial results.

During 2017, the GASB issued Statement No.87 - *Leases* ("GASB 87"). The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019 and earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements and we anticipate no material impact to the financial results from adopting and implementing GASB 87.

During 2018, the GASB issued Statement No.88 - *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements* ("GASB 88"). The primary objective of this Statement is to improve the information that is disclosed in the notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in the notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in the notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018 and earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements and we anticipate no material impact to the financial results from adopting and implementing GASB 88.

Note 4 – Change in Accounting Principle

On July 1, 2017, we adopted GASB Statement No. 75 - *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* ("GASB 75"). GASB 75 replaces the requirements of GASB Statements No. 45 - *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57 - *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB, Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for other postemployment benefit ("OPEB") plans. The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed in this Statement.

In the year of adoption, changes to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practical, for all prior periods presented. At the beginning of the period in which the provisions of this Statement are adopted, there may be circumstances in which it is not practical for a government to determine the amounts of all applicable deferred inflows of resources and deferred outflows of resources related to OPEB. In such circumstances, the government should report a beginning deferred outflow of resources for OPEB contributions made subsequent to the measurement date of the beginning net OPEB liability but before the beginning of the government's fiscal year. Additionally, in those circumstances, no other beginning balances for deferred outflows of resources and deferred inflows of resources related to OPEB should be reported. If restatement of all prior periods presented is not practical, the cumulative effect, if any, of applying this Statement should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated.

The Commonwealth prepared an actuarial valuation on the Retired Employees Health Program ("REHP"), and we received a separate unaudited valuation due to our unique REHP contribution arrangement with the Commonwealth. The separate valuation was prepared using PHEAA's census data and turnover assumptions, but it did not provide us with enough information to determine all of the applicable deferred inflows of resources and deferred outflows of resources related to OPEB. Therefore, we are reporting the cumulative effect of adopting GASB 75, which includes the restatement of beginning OPEB liability of $387.4 million and the restatement of beginning deferred outflows of resources of $4.7 million. The net effect of these adjustments to beginning total net position and beginning unrestricted net position was $382.7 million. In the table that follows, we present the net impact of the cumulative effect of adopting GASB 75 on total and unrestricted net position.

(Dollars in thousands)

Statement of Revenue, Expenses and Changes in Net Position	
Total net position, beginning of period, July 1, 2017	$ 687,032
Cumulative effect of adopting GASB 75	(382,668)
Total net position, beginning of period, July 1, 2017 (**restated**)	$ 304,364
Unrestricted net position, beginning of period, July 1, 2017	$ 263,709
Cumulative effect of adopting GASB 75	(382,668)
Unrestricted net position, beginning of period, July 1, 2017 (**restated**)	$ (118,959)

Note 5 – Federal Student Loan Reserve Fund (Federal Fund) and Assets Held for the U.S. Department of Education

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

(Dollars in thousands)

As of June 30,	**2018**	2017
Assets		
Cash	**$ 16,461**	$ 6,621
Receivable from the U.S. Department of Education	**53,354**	55,548
Other receivables	**757**	826
Total assets	**70,572**	62,995
Liabilities		
Accounts payable and accrued expenses	**1,033**	2,338
Amounts payable to PHEAA	**202,213**	205,935
Total liabilities	**203,246**	208,273
Net liabilities	**$ (132,674)**	$ (145,278)

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

As of June 30, 2018 and June 30, 2017, we reported $69.5 million and $60.7 million, respectively, in the line item "Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net" in the Statements of Net Position, which is the difference between the Federal Fund's total assets and accounts payable and accrued expenses, excluding amounts payable to PHEAA.

Note 6 – Cash, Cash Equivalents and Investments

Overview

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

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

General Investment Objectives

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

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

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

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

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

Standards of Care

The Board of Directors authorized the investments guidelines and we govern our investments by using the "prudent person" rule under our investment policy. 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.

Generally, our investments are limited to U.S. Government securities, U.S. Government agency securities, federal instrumentalities sponsored by U.S. agencies, high-grade commercial paper, repurchase agreements collateralized by U.S. Treasury obligations, certificates of deposit, bankers' acceptances eligible for purchase by the Federal Reserve System, and other investments approved by the board of directors from time to time.

The standard of prudence used in our investment portfolio shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio.

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

(Dollars in thousands)

As of June 30,	**2018**	2017
Cash and cash equivalents	**$ 64,452**	$ 126,142
Restricted cash and cash equivalents	**150,745**	312,787
Restricted cash and cash equivalents – due to customers	**78,015**	84,592
Investments	**424,641**	544,638
Restricted investments	**31,822**	28,999
Carrying value	**$ 749,675**	$1,097,158

Fair Value Measurement

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

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

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

(Dollars in thousands)

As of June 30, 2018	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Cash equivalents					
Money market funds:					
Federated money market funds	$ 139,866	$ 139,866	$ 139,866	$ -	$ -
PFM Funds Prime Series - Institutional shares	54,788	54,788	-	54,788	-
Federal agency discount notes	24,321	24,341	-	24,341	-
Commercial paper	38,866	38,993	-	38,993	-
Total cash equivalents by fair value level	$ 257,841	$ 257,988	$ 139,866	$ 118,122	$ -
Investments					
State Treasury investment pool:					
Pool 998	$ 151,926	$ 151,926	$ -	$ -	$ -
Pool 999	304,537	304,537	-	-	-
Total investments	$ 456,463	$ 456,463	$ -	$ -	$ -
Total cash equivalents and investments	$ 714,304	$ 714,451	$ 139,866	$ 118,122	$ -

(Dollars in thousands)

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

Cash Equivalents

Money Market Funds

Federated Money Market Funds – As of June 30, 2018 and 2017, we held positions in various Federated money market funds and the fair values of those funds were $139.9 million and $303.8 million, respectively. The fair values of the Federated money market funds were valued using quoted market prices (Level 1).

PFM Funds Prime Series – As of June 30, 2018 and 2017, we held positions in PFM Funds Prime Series and the fair values were $54.8 million and $98.4 million, respectively. The fair values of the PFM Funds Prime Series were valued based on the published net asset value per share by PFM, which were not obtained from a quoted price in an active market (Level 2).

Federal Agency Discount Notes

As of June 30, 2018 and 2017, we held positions in federal agency discounted notes and the fair values were $24.3 million and $49.1 million, respectively. The fair values of the federal agency discount notes were based on a market approach using quoted prices by a third party for markets that are not active (Level 2).

Commercial Paper

As of June 30, 2018 and 2017, we held positions in commercial paper and the fair values were $39.0 million and $39.5 million, respectively. The fair values of the commercial paper were based on a market approach using quoted prices by a third party for markets that are not active (Level 2).

Investments

<u>*State Treasury Investment Pool*</u>

Investment Pools 998 and 999

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

Pool 998

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

According to the Pennsylvania Treasury Annual Investment Report for the fiscal year ending June 30, 2017 (most recent annual report available), Pool 998's asset allocations were 69% invested in fixed income (including cash and cash equivalents) and 31% invested in equities and alternative assets. Pool 998 is benchmarked against a blended index of the Standard & Poor's 500 Index, the MCSI ACWI ex U.S. Index, the Barclay's Capital U.S. Aggregate Bond Index and the Merrill Lynch 6-Month U.S. Treasury Bill Index. For the equity portion of Pool 998's investments, a weighting of 75% is measured against the Standard & Poor's 500 Index and 25% is measured against the MCSI ACWI ex U.S. Index. For the fixed income portion of Pool 998's investments, a weighting of 83% is measured against the Barclay's Capital U.S. Aggregate Bond Index and 17% is measured against the Merrill Lynch 6-Month U.S. Treasury Bill Index. As of June 30, 2018 and 2017, our investments in Pool 998 were $151.9 million and $145.8 million, respectively.

Pool 999

Pool 999 maintains a stable NAV of $1 per share by investing exclusively in high quality fixed-income securities, primarily of short duration. Pool 999 is designed to generate income while minimizing investment volatility, which protects principal and ensures ready access to account balances through investments with easy liquidity. Pool 999's permitted investments include U.S. Treasury securities, federal agency securities, certificates of deposit, commercial paper, money market funds, repurchase agreements, and similar short-term fixed income instruments. According to the Pennsylvania Treasury Annual Investment Report for the fiscal year ending June 30, 2017 (most recent annual report available), Pool 999's asset allocations were 100% invested in fixed income (including cash and cash equivalents).

The value of a share in Pool 999 is calculated daily, incorporating all realized and unrealized gains and losses, and any cash returned from investments. All gains and losses are distributed to participants monthly to re-set the value to $1 per share. Pool 999's performance is benchmarked against the Merrill Lynch 3-Month U.S. Treasury Bill Index. As of June 30, 2018 and 2017, our investments in Pool 999 were $304.5 million and $427.8 million, respectively.

For more information on Pools 998 and 999, see the Pennsylvania Treasury "Annual Investment Report for Fiscal Year Ended June 30, 2017", which can be found at www.patreasury.gov under the title "Reports".

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

Interest Rate Risk

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

As of June 30, 2018 and 2017, $257.8 million and $490.7 million, respectively, of our cash equivalents have maturities of less than one year. As of June 30, 2018 and 2017, $456.5 million and $573.6 million, respectively, of our investments in the State Treasury Investment Pool have maturities of less than one year.

Credit Risk

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

As of June 30, 2018, all of our investments in commercial paper were rated at least A-1. As of June 30, 2018, all of our investments in money market funds were rated AAAm. As of June 30, 2018, $456.5 million was invested in the State Treasury investment pool, and the investment pool was not rated.

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

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, 2018, we had $14.7 million of cash deposits with financial institutions of which $14.5 million was in excess of the federal depository insurance limits.

Concentration of Credit Risk

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

As of June 30, 2018 and 2017, we did not have investments in a single issuer that represented 5% or more of our total cash equivalents and investments.

Note 7 – Student Loans Receivable, net

The following table shows our student loan holdings.

(Dollars in thousands)

As of June 30,	**2018**	2017
FFEL student loans:		
Consolidation	**$ 3,674,455**	$ 4,057,477
Stafford	**816,667**	849,572
PLUS	**66,904**	75,457
SLS	**711**	812
Total FFEL student loans	**4,558,737**	4,983,318
Private and HEAL student loans:		
Private	**16,531**	20,133
HEAL	**11,920**	19,103
Total private and HEAL student loans	**28,451**	39,236
Total student loans receivable	**4,587,188**	5,022,554
Unamortized student loan purchase premium	**3,431**	5,559
Unamortized student loan purchase discount	**(9,240)**	(8,308)
Allowance for loan losses	**(6,131)**	(6,646)
Total student loan receivable, net	**$ 4,575,248**	$ 5,013,159

Allowance for loan losses

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

(Dollars In thousands)

As of June 30,	**2018**	2017
Balance at beginning of period	**$ 6,646**	$ 21,229
Provision for losses - FFEL program loans	**3,323**	3,228
Provision for losses - Other program loans (Non-FFEL)	**215**	667
Charge-offs - FFEL program loans	**(3,842)**	(13,532)
Charge-offs - Other program loans (Non-FFEL)	**(211)**	(4,946)
Balance at end of period	**$ 6,131**	$ 6,646

Note 8 – Capital Assets, net

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

(Dollars in thousands) As of and for the year ended June 30, 2018	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 8,038	$ -	$ -	$ 8,038
Buildings and improvements	76,067	127	(178)	76,016
Software	58,310	19,878	(3,597)	74,591
Information technology equipment	23,411	2,915	(282)	26,044
Other equipment	18,464	82	(300)	18,246
Total capital assets	184,290	23,002	(4,357)	202,935
Less accumulated depreciation and amortization for:				
Buildings and improvements	(44,403)	(2,059)	76	(46,386)
Software	(27,984)	(12,089)	3,593	(36,480)
Information technology equipment	(11,393)	(4,279)	275	(15,397)
Other equipment	(12,272)	(1,618)	243	(13,647)
Total accumulated depreciation and amortization	(96,052)	(20,045)	4,187	(111,910)
Total capital assets, net	$ 88,238	$ 2,957	$ (170)	$ 91,025

Depreciation expense for the years ended June 30, 2018 and 2017 was $20.0 million and $16.8 million, respectively.

Note 9 – Notes and Bonds Payable and Other Financings

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

(Dollars in thousands) As of and for the year ended June 30, 2018	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due within One Year
Student loan financings:					
Student loan floating rate notes, due 2028-2065 at weighted-average rates of 2.89% as of June 30, 2018 and 1.95% as of June 30, 2017	$ 4,599,943	$ -	$ (741,341)	$ 3,858,602	$ -
Deferred gain on bond refunding of student loan floating rate notes	82,247	63	(40,303)	42,007	-
Deferred loss on bond refunding of student loan floating rate notes	(841)	805	(2,309)	(2,345)	-
Discount on student loan floating rate notes	(10,296)	3,387	-	(6,909)	-
Student loan auction rate security bonds due 2042, at interest rate of 2.55% as of June 30, 2018 and a weighted-average interest rate of 2.29% as of June 30, 2017	173,150	-	(162,050)	11,100	-
Student loan financings warehouse facilities due 2019 at an interest rate of 3.23% as of June 30, 2018	-	421,932	(175,946)	245,986	-
Student loan financings, due on demand, at an an interest rate of 2.83% as of June 30, 2018 and 1.73% as of June 30, 2017	200,000	40,000	-	240,000	240,000
Total student loan financings	$ 5,044,203	$ 466,187	$ (1,121,949)	$ 4,388,441	$ 240,000
Other financings:					
Capital acquisition refunding bonds, Series of 2012, due 2018 - 2022, at weighted-average rates of 4.15% as of June 30, 2018 and 2017	22,300	-	(4,055)	18,245	4,230
Unamortized premium on capital acquisition refunding bonds	1,574	-	(491)	1,083	-
Term financings, due 2029, at zero percent as of June 30, 2018 and June 30, 2017.	6,280	-	-	6,280	-
Total other financings	30,154	-	(4,546)	25,608	4,230
Total student loan and other financings	$ 5,074,357	$ 466,187	$ (1,126,495)	$ 4,414,049	$ 244,230

The note and bond indentures, among other things, require us to comply with various covenants, such as parity ratio requirements and annual financial statement, servicing and administration audits. Student loans and investments collateralize all student loan financings. As of June 30, 2018, $4.6 billion of student loan principal and related interest receivable and $146.0 million of cash equivalents collateralized the $4.4 billion of student loan financings.

As of June 30, 2018, the student loan financings and other financings are non-recourse obligations to our unrestricted net position and to the Commonwealth, except for the $240.0 million of student loan financings and $18.2 million of Capital Acquisition Refunding Bonds, Series of 2012, which are recourse obligations to us.

Student loan financings

For the year ended June 30, 2018, the student loan financings increased $466.2 million primarily due to PHEAA drawing funds from the PHEAA Warehouse Facility Trust 2013-1 and our student loan financings facility, which were used to redeem the PHEAA Student Loan Trust I auction rate security bonds and purchase rehabilitated student loans.

For the year ended June 30, 2018, the student loan financings decreased $1.1 billion due to the redemption of the PHEAA Student Loan Trust I auction rate security bonds (mentioned above), required debt payments, scheduled amortization of deferred gains and losses on bond refundings and scheduled amortization of discounts on student loan floating rate notes.

Other financings

For the year ended June 30, 2018, other financings decreased $4.5 million due to required principal and interest payments on the Capital Acquisition Refunding Bonds, Series of 2012 and amortization of premium on capital acquisition refunding bonds.

Debt service requirements

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

(Dollars In thousands)	**Student Loan Financings**		**Other Financings**	
Fiscal Year of Maturity	**Principal**	**Interest**	**Principal**	**Interest**
2019	$ 240,000	$ 120,432	$ 4,230	$ 661
2020	245,986	111,932	4,415	482
2021	-	111,932	4,595	295
2022	-	111,932	4,795	100
2023	-	111,932	210	4
2024-2028	38,595	559,087	-	-
2029-2033	138,211	539,839	6,280	-
2034-2038	1,253,571	502,737	-	-
2039-2043	1,570,152	290,155	-	-
2044-2048	44,850	129,306	-	-
2049-2053	-	126,555	-	-
2054-2058	155,820	122,022	-	-
2059-2063	-	105,977	-	-
2064-2068	668,503	48,791	-	-
	$ 4,355,688	$ 2,992,629	$ 24,525	$ 1,542

The student loan financings are variable-rate debt, which have interest rates that reset on various dates. As of June 30, 2018, interest rates on $11.1 million reset based upon auctions every 28 days, $4.1 billion was indexed to the 1-month or 3-month LIBOR and $246.0 million was indexed to the asset-backed commercial paper rate.

Note 10 – Retirement and Other Postemployment Benefits

Retirement Plan

Plan Description

We contribute to the Commonwealth of Pennsylvania State Employees' Retirement System ("SERS"), which the Commonwealth established under the provisions of Public Law 858, No. 331. SERS is the administrator of a cost-sharing multiple-employer defined benefit retirement plan to provide pension benefits, including retirement, death, and disability 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 CAFR as a pension trust fund. As a pension trust fund, SERS issues a CAFR that includes financial statements and required supplementary information. The SERS CAFR is available on-line at www.sers.pa.gov, select "Newsroom", select "SERS Facts" and the CAFRs are listed by year under the section titled "Comprehensive Annual Financial Reports". Written requests for the SERS CAFR should be directed to the following address: State Employees' Retirement System, 30 North Third Street, Suite 150, Harrisburg, Pennsylvania 17101-1716.

Summary of Significant Accounting Policies

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

Retirement Benefits

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

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

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

Funding Policy

The State Employees Retirement Code ("SERC"), section 5507, requires the Commonwealth and other employers whose employees are SERS members to make contributions to the fund on behalf of all active members and annuitants necessary to fund the liabilities and provide the annuity reserves required to pay benefits. The SERS board of directors certifies the employer contribution rates on an annual basis, typically in April of each year to become effective the following fiscal year beginning in July. The employer rates are determined based on an independent actuarial valuation of the pension fund. The actuarial valuation assesses the pension system's current funds and determines its future expected liabilities. The employer contribution rate is set so that it can fund all retirement benefits earned by employees working during the year and pay toward any unfunded liability that may exist. In some cases, the actuarially calculated employer contribution rate has been set or adjusted by Pennsylvania law. According to the SERC, all obligations of SERS will be assumed by the Commonwealth should SERS terminate. Lastly, PA Act 120 imposed rate collars that limited employer contribution rate increases and on July 1, 2017, those rate collars were no longer needed requiring PHEAA to pay the full actuarial required rate.

For the year ended June 30, 2018, the employer contribution rates were 27.55% for the "A" Class of Service employees, 34.44% for the "AA" Class of Service employees and 23.80% for the "A-3" and "A-4" Class of Service employees. For the year ended June 30, 2017, the employer contribution rates were 23.96% for the "A" Class of Service employees, 29.95% for the "AA" Class of Service employees and 20.70% for the "A-3" and "A-4" Class of Service employees.

SERS GASB 68 Valuation

SERS released the "GASB 68 Valuation" to the cost-sharing employers of the multiple-employer defined benefit retirement plan.

In the sections titled "Assumptions and Other Inputs" and the "GASB 68 Employer Amounts" that follow, SERS provided us the information and the amounts presented are considered elements of the financial statements of SERS and PHEAA. In some cases, SERS provided us with total plan-level information in which we applied our proportionate share percentage in to order to calculate the required amounts under GASB. As stated previously in the "Plan Description", separately issued financial statements for SERS can be obtained from SERS management at www.sers.pa.gov.

PHEAA's Allocation Percentage Methodology

The allocation percentage assigned to PHEAA was based on a projected-contribution method. This methodology applies the most recently calculated contribution rates for the Commonwealth's 2018-2019 and 2017-2018 fiscal years, from the December 31, 2017 and 2016 funding valuation, to the expected funding payroll for the allocation of the calendar year 2017 and 2016 amounts.

The amounts assigned to us were our proportionate share of the net pension liability, pension expense, deferred outflows of resources and deferred inflows of resources (the collective pension amounts) determined in accordance with GASB 68. Our allocation percentages have been rounded for presentation purposes, therefore amounts presented in the following tables may result in immaterial differences due to this rounding.

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

(Dollars in thousands)

As of June 30, 2018	
Projected contributions, July 1, 2018 through June 30, 2019	**$ 48,855**
Total projected contributions, July 1, 2018 through June 30, 2019	**$ 2,041,137**
Employer allocation percentage	**2.39%**

(Dollars in thousands)

As of June 30, 2017	
Projected contributions, July 1, 2017 through June 30, 2018	$ 50,665
Total projected contributions, July 1, 2017 through June 30, 2018	$ 2,055,496
Employer allocation percentage	2.46%

Proportionate Share of Net Pension Liability

As of June 30, 2018, our proportionate share of the net pension liability was $413.9 million. The net pension liability was measured as of December 31, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. As of June 30, 2017, our proportionate share of net pension liability was $474.7 million. The net pension liability was measured as of December 31, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The SERS valuation measurement dates of December 31, 2017 and 2016 were not the same as PHEAA's fiscal years end of June 30, 2018 and 2017.

The following table presents the calculation of our proportionate share of net pension liability as of June 30, 2018 and 2017. As stated previously, PHEAA's proportionate share percentage was rounded to the nearest hundredth of a percent; therefore, you will not be able to recalculate "PHEAA's proportionate share of net pension liability".

(Dollars in thousands)

As of June 30,	**2018**	2017
SERS collective net pension liability	**$ 17,291,709**	$ 19,260,326
PHEAA's allocation percentage	**2.39%**	2.46%
PHEAA's proportionate share of net pension liability	**$ 413,878**	$ 474,743

Assumptions and Other Inputs

Actuarial Methods and Assumptions

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

The SERS board adopted the actuarial assumptions set forth in the *18th Investigation of Actuarial Experience* at its March 2016 meeting. The study can be viewed at www.SERS.pa.gov. In addition to the five-year experience study, SERS reviews its investment return assumption in light of economic conditions every year. The next SERS review will occur in July 2018, and will be used for its 2018 annual valuation.

The following methods and assumptions were used in the GASB 68 Valuation for the December 31, 2017 and 2016 measurement dates:

- Actuarial cost method – entry age
- Amortization method – straight-line amortization of investments over five years and amortization of assumption changes and noninvestment gains/losses over the average expected remaining service lives of all employees that provided benefits
- Investment rate of return – 7.25% net of expenses including inflation
- Projected salary increases – average of 5.60% with a range of 3.70% to 8.90% including inflation
- Asset valuation method – fair market value
- Inflation – 2.60%
- Mortality rate – projected RP-2000 Mortality Tables adjusted for actual plan experience and future improvement
- Cost of living adjustment – none (ad hoc)

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

Asset Class	Target allocation	Long-term expected real rate of return
Private equity	16.00%	8.00%
Global public equity	43.00%	5.30%
Real estate	12.00%	5.44%
Hedge funds	12.00%	5.10%
Fixed income	14.00%	1.63%
Cash	3.00%	(0.25%)
Total	100.00%	

The information presented in the table above was based on a 7.5% assumed investment rate of return. At the April 2017 meeting, the SERS Board of Directors approved a reduction in the assumed investment rate of return to 7.25%. As a result of a portfolio examination, several changes were made to the asset allocation during the fourth quarter of 2017. The portfolio was restricted to add Multi-Strategy as a new asset class. Targets will be updated to reflect the new assumed investment rate of return and asset classes in the *2018-2019 Investment Plan*.

Discount Rate

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

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

The following table presents our proportionate share of the net pension liability calculated using the discount rate of 7.25% as of June 30, 2018 and 2017, as well as the impact on the net pension liability if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate.

(Dollars in thousands) As of June 30,	1% decrease to 6.25%	Current discount rate of 7.25%	1% increase to 8.25%
2018	**$ 525,340**	**$ 413,878**	**$ 318,398**
2017	$ 587,517	$ 474,743	$ 378,169

GASB 68 Employer Amounts

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

As of June 30, 2018, our deferred outflows of resources and deferred inflows of resources related to pensions were $76.9 million and $34.5 million, respectively. As of June 30, 2017, our deferred outflows of resources and deferred inflows of resources related to pensions were $134.0 million and $11.6 million, respectively.

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

(Dollars in thousands)

Deferred Outflows of Resources

As of June 30,	Differences between expected and actual experience	Net difference between projected and actual investment earnings on pension plan	Changes in assumptions	Differences between employer contributions and proportionate share of contributions	Changes in proportion	Contributions subsequent to the measurement date	Total Deferred Outflow of Resources
2018	$6,998	$ -	$20,721	$300	$24,025	$24,873	$76,917
2017	$6,853	$39,897	$28,998	$ -	$35,291	$22,930	$133,969

(Dollars in thousands)

Deferred Inflows of Resources

As of June 30,	Differences between expected and actual experience	Net difference between projected and actual investment earnings on pension plan investments	Differences between employer contributions and proportionate share of contributions	Changes in proportion	Total Deferred Inflow of Resources
2018	$7,858	$16,456	$655	$9,580	$34,549
2017	$10,622	$ -	$979	$ -	$11,601

Net Amortization of Deferred Outflows of Resources and Deferred Inflows of Resources

The components of deferred outflows of resources and deferred inflows of resources, other than the net difference between the projected and actual investment earnings on SERS pension plan investments, are amortized into pension expense over 5.2 years. The net difference between the projected and actual investment earnings on SERS pension plan investments are amortized in pension expense over 5.0 years.

The net amounts of deferred outflows of resources and deferred inflows of resources related to the items previously reported as of June 30, 2018, which will be recognized in pension expense in future periods are as follows:

(Dollars in thousands)

For the years ended June 30,	2019	2020	2021	2022	2023	Thereafter
Net amortization	$ 19,241	$ 15,271	$ (5,206)	$ (11,489)	$ (323)	$ -

Pension Expense

For the years ended June 30, 2018 and 2017, our proportionate share of total pension expense was $66.0 million and $79.7 million, respectively. The components of our proportionate share of total pension expense are as follows:

(Dollars in thousands) For the years ended June 30,	Proportionate Share of Plan Pension Expense	Net amortization difference between employer contributions and proportionate share of contributions	Net amortization of deferred amounts from changes in proportion	Total employer pension expense
2018	$57,306	($252)	$8,985	$66,039
2017	$68,709	($324)	$11,266	$79,651

Other Postemployment Benefits

Plan Description

The Retired Employees Health Program ("REHP") provides post-employment healthcare benefits for eligible retirees and their dependents. The REHP is a single employer defined benefit Other Postemployment Benefit ("OPEB") plan that includes Commonwealth agencies and some component units. PHEAA accounts for and reports its participation in the REHP as if it were a cost-sharing employer for financial reporting purposes. The REHP is administered by the Pennsylvania Employees Benefit Trust Fund ("PEBTF"), which acts as a third-party administrator for the REHP under an administrative agreement with the Commonwealth. The REHP is a trust equivalent arrangement. The REHP is provided as a part of collective bargaining agreements with most Commonwealth labor unions. All policy decisions, types, and levels of benefits for the REHP fall under the purview of the Commonwealth's Executive Board, Secretary of Administration. The REHP does not have a governing board.

The REHP is reported in the Commonwealth's CAFR as a "Pension (and Other Employee Benefit) Trust". The REHP is reported using the economic resources measurement focus and the accrual basis of accounting. The Commonwealth's CAFR (June 30, 2017) is audited and available at www.budget.pa.gov.

Funding and Eligibility Policy

The Pennsylvania Office of Administration ("OA") 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. All employing agencies and certain plan members contributed $362 per bi-weekly pay period for each current REHP eligible active employee during fiscal year ended June 30, 2017 to the REHP Trust. PHEAA and certain other agencies do not contribute to the REHP Trust; instead, we contribute under a separate payment arrangement. OA calculates PHEAA's monthly contribution rate based on the projected per retiree cost and the number of estimated PHEAA retirees. OA and PHEAA performs a reconciliation at the end of the fiscal year based on actual and allocated number of retirees each month and the average per retiree cost for the fiscal year. Any adjustments resulting from the reconciliation are due to either the Commonwealth or PHEAA. As of June 30, 2018 and 2017, PHEAA's contributions were $4.1 million and $4.7 million, respectively. As of June 30, 2018 and 2017, we have made all required contributions to the REHP as determined by OA.

Eligible employees who retire from the Commonwealth and meet one of the following eligibility criteria are eligible to receive REHP benefits:

- 25 or more years of service;
- 20 or more years of service and superannuation age – Age 60 for general employees (age 55 or 65 for employees subject to Act 120 of 2010); and
- Disability retirement – requires five years of service.

Spouses and dependents are eligible for subsidized postemployment medical coverage while the retiree is alive.

For employees who retired before July 1, 2005, the Commonwealth pays the retirees cost. For employees who retired after June 30, 2005 and before July 1, 2007, the retiree contributions are 1% of employee's final annual salary. For employees who retired on or after July 1, 2007 but before July 1, 2011, the retiree contributions are 3% for non-Medicare and 1.5% for Medicare of either final gross annual base salary or final average salary, whichever is less. For employees who retired on or after July 1, 2011, the retiree contributions are 3% of their final average salary for non-Medicare and 1.5% of final average salary for Medicare. Surviving spouses of deceased retirees may continue to participate in the plan if they pay the full cost of the coverage.

OPEB GASB 75 Valuation

The Commonwealth issued the "Commonwealth of Pennsylvania Retired Employees Health Program GASB Statement Nos. 74 and 75 Valuation Report" ("OPEB Valuation"), which included a separate valuation for PHEAA and certain other agencies due to our unique contribution arrangement with the Commonwealth. The information that follows in "Assumptions and Other Inputs" was included in the valuation referenced above.

Assumptions and Other Inputs

Actuarial Methods and Assumptions

SERS performs experience studies periodically to determine reasonable and appropriate economic and demographic assumptions for purposes of valuing the defined benefit pension plan. The most recent SERS experience study covered the years 2011 through 2015 and was presented to the SERS Board of Directors in March 2016. The approved recommendations from that study were used to determine the assumptions for the OPEB Valuation, where applicable. The SERS Board selected the inflation assumption during an April 2017 meeting based on a review of actual plan experience and the prevalent economic outlook. Consistent with prior valuations, these demographic assumptions assume beginning of year decrements (retirement, withdrawal, death, disability, etc.). In addition, the Commonwealth's actuary periodically reviews actuarial assumptions only applicable to the postemployment medical plan outside of the experience study, such as medical trend rates and medical rates.

One significant assumption where the recommendation of the experience study is not applicable to the OPEB Valuation is the discount rate. Since REHP has insufficient assets to meet next year's projected benefit payments, as prescribed by GASB Nos. 74 and 75, the discount rate was based on the index rate for the 20-year tax-exempt general obligation municipal bond index rate with an average rating of AA/Aa or higher as of the measurement date. The Commonwealth elected to determine the discount rate using the Bond Buyer 20-Bond General Obligation Index.

The treatment of Medicare Part D in the OPEB Valuation is consistent with GASB technical bulletin 2006-1 issued in June 2006, which states that Medicare Part D subsidy payments should not be reflected under GASB No. 45 (predecessor statement to GASB No. 75).

The following methods and assumptions were used in the OPEB Valuation for the June 30, 2017 measurement date:

- Actuarial cost method – entry age normal
- Actuarial value of assets – market value of assets on the valuation date
- Census date – December 31, 2016 for June 30, 2017 and 2016 measurements
- Discount rate – 3.58% as of June 30, 2017 and 2.85% as of June 30, 2016
- Inflation – 2.60%
- Investment rate of return – 5.0%
- Medical trend rate – initial - $6.0%, ultimate – 3.9%, year reached - 2075
- Mortality rate – *Healthy Participants* - RP-2000 Male and Female Combined Healthy Mortality Tables (Projection Scale AA) to 2016 for males and to 2020 for females. *Disabled Participants* - The RP-2000 Male and Female Disabled Retiree Mortality Tables projected (using Projection Scale AA) to 2021 for males and to 2017 for females. Each table includes a margin for future improvement in life expectancy.
- Payroll growth – 2.90%
- Plan fiduciary net position – market value of assets as of the measurement date

The long-term expected real rate of return on REHP plan investments is determined using a risk premium review. This review compares the current relationship between fixed income and equity and their relationship over long periods of time to come up with an expected rate of return. Other variables considered in the expected rates of return are a reversion of the mean for each asset class. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation are summarized in the table that follows:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
U.S. Equity	47.0%	7.5%
International Equity	20.0%	8.5%
Fixed Income	25.0%	3.0%
Real Estate	8.0%	3.0%
Cash	-	1.0%
Total	100.00%	

OPEB Plan's Fiduciary Net Position

Detailed information about the REHP's fiduciary net position is included in the Commonwealth's CAFR within the Combining Statement of Changes in Fiduciary Net Position. As stated in the "Plan Description", the Commonwealth's CAFR is audited and available at www.budget.pa.gov.

Total OPEB Liability and Sensitivity to Changes in the Discount and Medical Trend Rates

As of June 30, 2018, PHEAA's total OPEB liability was $357.1 million. PHEAA's total OPEB liability was determined by a separate valuation prepared by the Commonwealth. The OPEB Valuation had a valuation date and a measurement date of June 30, 2017 for the fiscal year ended June 30, 2018. The measurement date of June 30, 2017 is not the same as PHEAA's fiscal year end date of June 30, 2018.

The tables that follow presents our total OPEB liability, as of June 30, 2018, calculated using the discount rate of 3.58% and the medical trend rate of 3.90% as well as the impact on the OPEB liability if it were calculated using the discount and medical trend rates that are one percentage point lower or one percentage point higher than the current rates.

(Dollars in thousands)	1% decrease	Rate	1% increase
As of June 30, 2018 - Discount rate – 3.58%	$431,970	$357,062	$297,778
As of June 30, 2018 – Medical trend rate – 3.90%	285,231	357,062	452,748

Total OPEB Expense, Total Deferred Outflows of Resources and Total Inflows of Resources

For the years ended June 30, 2018 and 2017, total OPEB expense was $20.7 million and $4.7 million, respectively.

As of June 30, 2018, our deferred outflows of resources and deferred inflows of resources related to OPEB were $4.1 million and $46.3 million, respectively.

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

(Dollars in thousands)

Deferred Outflows of Resources

As of June 30,	Contributions subsequent to the measurement date	Total Deferred Outflow of Resources
2018	**$4,062**	**$4,062**

Dollars in thousands)

Deferred Inflows of Resources

As of June 30,	Changes in assumptions	Total Deferred Inflow of Resources
2018	**$46,299**	**$46,299**

Amortization of Deferred Inflows of Resources

The changes in assumptions component of the deferred inflows of resources are amortized into OPEB expense over 7.5 years as follows:

(Dollars in thousands)

For the years ended June 30,	2019	2020	2021	2022	2023	Thereafter
Deferred inflows of resources	$6,141	$6,141	$6,141	$6,141	$6,141	$15,594

Note 11 – Net Position

We have net position invested in capital assets, which includes land, buildings and improvements, software, information technology equipment, and other tangible assets used in our operations. These capital assets are net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. As of June 30, 2018, net investment in capital assets amounted to $91.0 million, and as of June 30, 2017, net investment in capital assets amounted to $88.2 million.

We have net position restricted for debt service held under various indentures related to financing our student loan portfolios. As of June 30, 2018, net position restricted for debt service amounted to $341.8 million, and as of June 30, 2017, net position restricted for debt service amounted to $305.8 million.

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. The net position is restricted until we disburse program-related grants. As of June 30, 2018, net position restricted for financial aid grant programs amounted to $33.0 million, and as of June 30, 2017, net position restricted for financial aid grant programs amounted to $29.3 million.

We have net position that is unrestricted, which is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Under Commonwealth law, our purpose is to increase higher education opportunities for Pennsylvania residents. Net position that we report as unrestricted are statutorily restricted to our purpose. The Higher Education Amendments of 1998 also restricts our use of net position related to

FFEL guaranty activities to fulfilling our guaranty responsibilities and other student financial aid related activities selected by us. This restriction is consistent with our statutory purpose and we consider the net position related to those activities to be unrestricted. As of June 30, 2018, unrestricted net position amounted to a negative $244.4 million of which net position related to the guaranty activities was $91.7 million. As of June 30, 2017, unrestricted net position amounted to $263.7 million of which net position related to the guaranty activities was $107.4 million.

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, 2018 and 2017, total servicing revenues were $317.6 million and $321.4 million, respectively. For the years ended June 30, 2018 and 2017, we were servicing on average $343.4 billion and $320.3 billion, respectively, of loans for third party customers. For the years ended June 30, 2018 and 2017, customers using our servicing systems serviced on average $63.1 billion and $52.3 billion, respectively, of loans.

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

For the year ended June 30, 2018, ED provided $194.8 million of servicing revenue, which represents 61.3% of the total servicing revenue. The next three loan-servicing customers provided $53.5 million of servicing revenue, which represents 16.8% of the total servicing revenue.

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

Note 13 – Segment Information

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

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the years ended June 30,	**2018**	2017
Interest revenue	**$ 158,010**	$ 143,689
Interest expense	**(72,951)**	(37,781)
Net interest revenue	**85,059**	105,908
Provision for loan losses	**(2,884)**	(2,536)
Net interest revenue after provision for loan losses	**82,175**	103,372
Total noninterest revenue	**963**	314
Total operating revenues	**83,138**	103,686
Total operating expenses	**(27,383)**	(39,456)
Operating income	**55,755**	64,230
Transfers to unrestricted net position	**(19,687)**	(68,774)
Change in net position	**36,068**	(4,544)
Net position, beginning of period	**305,780**	310,324
Net position, end of period	**$ 341,848**	$ 305,780

Statements of Net Position

(Dollars in thousands)

As of June 30,	2018	2017
Current assets:		
Restricted cash and cash equivalents	**$ 145,992**	$ 308,989
Student loans receivable	**734,942**	840,652
Interest income receivable	**89,978**	71,554
Other assets	**-**	6
Total current assets	**970,912**	1,221,201
Long-term assets:		
Student loans receivable, net	**3,770,836**	4,148,573
Total long-term assets	**3,770,836**	4,148,573
Total assets	**4,741,748**	5,369,774
Deferred outflow of resources:		
Deferred loss on bond refundings	**2,345**	841
Total deferred outflow of resources	**2,345**	841
Current liabilities:		
Accounts payable and accrued expenses	**11,459**	19,791
Student loan financings	**240,000**	200,000
Total current liabilities	**251,459**	219,791
Long-term liabilities:		
Student loan financings, net	**4,108,779**	4,762,797
Total long-term liabilities	**4,108,779**	4,762,797
Total liabilities	**4,360,238**	4,982,588
Deferred inflow of resources:		
Deferred gain on bond refundings	**42,007**	82,247
Total deferred inflow of resources	**42,007**	82,247
Net position		
Restricted for debt service	**341,848**	305,780
Total net position	**$ 341,848**	$ 305,780

Statements of Cash Flows

(Dollars in thousands)

For the years ended June 30,	**2018**	2017
Cash flows from operating activities		
Interest received on student loans	**$ 67,612**	$ 71,289
Principal received on student loans	**813,247**	988,038
Student loan purchases	**(449,050)**	(834,759)
Student loan sales, including net gains and losses	**187,027**	790,606
Other	**83**	-
Payment of operating expenses	**(37,469)**	(32,806)
Net cash provided by operating activities	**581,450**	982,368
Cash flows from noncapital financing activities		
Proceeds from issuance of noncapital debt	**461,932**	925,568
Principal paid on noncapital debt	**(1,081,646)**	(1,656,985)
Interest paid on noncapital debt	**(106,853)**	(84,384)
Bond issuance costs	**(333)**	(8,164)
Other	**(19,687)**	(68,774)
Net cash used for noncapital financing activities	**(746,587)**	(892,739)
Cash flows from investing activities		
Interest received on investments	**2,140**	778
Net cash provided by investing activities	**2,140**	778
Net change in restricted cash and cash equivalents	**(162,997)**	90,407
Restricted cash and cash equivalents, beginning of period	**308,989**	218,582
Restricted cash and cash equivalents, end of period	**$ 145,992**	$ 308,989

There are eighteen separate trusts with parity ratios, a ratio of assets to liabilities. As of June 30, 2018, the trusts had parity ratios ranging from 1.030 to 1.506. Two of the eighteen trusts have minimum parity ratio requirements and as of June 30, 2018, the trusts complied with the minimum parity ratio requirements.

Note 14 – Blended Component Units

We consider the PHEAA Student Loan Trust I (the "Trust"), the PHEAA Student Loan Trust 2011-1, the PHEAA Student Loan Trust 2012-1, the PHEAA Student Loan Trust 2013-1, the PHEAA Student Loan Trust 2013-2, the PHEAA Student Loan Trust 2013-3, the PHEAA Student Loan Trust 2014-1, the PHEAA Student Loan Trust 2014-2, the PHEAA Student Loan Trust 2014-3, the PHEAA Student Loan Trust 2015-1, the PHEAA Student Loan Trust 2016-1, the PHEAA Student Loan Trust 2016-2 and the PHEAA Warehouse Facility Trust 2013-1, collectively "PHEAA SLTs", blended component units ("BCUs").

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

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

On August 17, 2017, PHEAA via the Foundation redeemed the Series 2004-1 Class A-2 notes of the Trust. On August 31, 2017, PHEAA via the Foundation redeemed the Series 2004-1 Class A-3 notes of the Trust and officially terminated the Trust.

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

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the years ended June 30,	**2018**	2017
Interest revenue	**$ 131,978**	$ 120,767
Interest expense	**(56,248)**	(24,738)
Net interest revenue	**75,730**	96,029
Provision for loan losses	**(2,295)**	(3,206)
Net interest revenue after provision for loan losses	**73,435**	92,823
Total operating expenses	**(22,612)**	(33,190)
Operating income	**50,823**	59,633
Transfers to unrestricted net position	**(21,261)**	(30,955)
Change in net position	**29,562**	28,678
Net position, beginning of period	**216,942**	188,264
Net position, end of period	**$ 246,504**	$ 216,942

Statements of Net Position

(Dollars in thousands)

For the years ended June 30,	**2018**	2017
Current assets:		
Restricted cash and cash equivalents	**$ 102,587**	$ 146,677
Student loans receivable	**596,125**	761,153
Interest income receivable	**79,350**	65,086
Other assets	**-**	6
Total current assets	**778,062**	972,922
Long-term assets:		
Student loans receivable, net	**3,113,660**	3,490,489
Total long-term assets	**3,113,660**	3,490,489
Total assets	**3,891,722**	4,463,411
Total deferred outflow of resources	**636**	668
Current liabilities:		
Accounts payable and accrued expenses	**6,948**	16,661
Student loan financings	**245,986**	-
Total current liabilities	**252,934**	16,661
Long-term liabilities:		
Student loan financings, net	**3,350,913**	4,148,229
Total long-term liabilities	**3,350,913**	4,148,229
Total liabilities	**3,603,847**	4,164,890
Total deferred inflow of resources	**42,007**	82,247
Net position		
Restricted for debt service	**246,504**	216,942
Total net position	**$ 246,504**	$ 216,942

Statements of cash flows

(Dollars in thousands)

For the years ended June 30,	**2018**	2017
Net cash provided by operating activities	**$ 622,630**	$ 536,690
Net cash used for noncapital financing activities	**(668,173)**	(511,814)
Net cash provided by investing activities	**1,453**	531
Net change in restricted cash and cash equivalents	**(44,090)**	25,407
Restricted cash and cash equivalents, beginning of period equivalents	**146,677**	121,270
Restricted cash and cash equivalents, end of period equivalents	**$ 102,587**	$ 146,677

Note 15 – Risk Management, Contingencies, and Legal Proceedings

Risk Management and Contingencies

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

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

Legal Proceedings

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

As previously reported, in *U.S. ex. rel. Jon H. Oberg v. Kentucky Higher Ed. Student Loan Corp., et. al.*, Dr. Jon H. Oberg, a former U.S. Department of Education employee, filed a False Claims Act ("FCA") case in the United States District Court for the Eastern District of Virginia against several public and private student loan financing entities. PHEAA was served with a copy of Oberg's First Amended Complaint on or about September 29, 2009. The First Amended Complaint alleged that the defendants submitted claims to the U.S. Department of Education for special allowance payments providing a 9.5% floor on the return on certain loans, including loans that were not eligible for such a special allowance. It further alleged that PHEAA in particular obtained approximately $92 million in unlawful payments from the Department of Education. The FCA provides for treble damages and civil penalties.

After several appeals, the case was heard on the merits in the Eastern District of Virginia. On December 5, 2017, the jury found in favor of PHEAA. On January 8, 2018, Dr. Oberg filed an appeal to the United States Court of Appeals for the Fourth Circuit from the Final Order dated December 5, 2017. On March 20, 2018, Oberg submitted his brief in support of his appeal. In response, PHEAA filed its opposition brief on April 27, 2018. The matter has been set for oral arguments during the week of October 30, 2018. As of June 30, 2018, and through the date of this report, we believe it is remote that a loss contingency exists, and we will continue to contest this matter vigorously.

Commonwealth of Massachusetts

As a larger participant defined by the Bureau of Consumer Financial Protection in the market for student loan servicing, we are the subject of various subpoenas, requests, and actions by various state and federal regulatory bodies. On August 23, 2017, the Commonwealth of Massachusetts ("Massachusetts"), by and through its Attorney General, brought an enforcement action pursuant to the Massachusetts Consumer Protection Act, and the Consumer Financial Protection Act against PHEAA, d/b/a Fedloan Servicing. PHEAA does not agree with the allegations made by the Massachusetts Attorney General's Office with regards to their findings. However, PHEAA remains committed to appropriately resolving any outstanding borrower issues while following the U.S. Department of Education's policies, procedures, and regulations as mandated by the PHEAA's federal contracts. PHEAA will continue working with the U.S. Department of Education's Office of Federal Student Aid to help resolve any issue identified by the Massachusetts Attorney General. On January 8, 2018, the United States Department of Justice submitted a Statement of Interest on this case stating that Massachusetts claims were preempted by Federal law. PHEAA filed a motion to dismiss, which was denied by the court. The matter is now proceeding through the discovery phase of litigation. As of June 30, 2018 and through the date of this report, we believe it is remote that a loss contingency exists, and we will continue to contest this matter vigorously.

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, 2018 and through the date of this report.

Required Supplementary Information

Pension

The schedules that follow are required supplementary information and are presented as of and for the year ended December 31, 2017 (**measurement date**) and as of and for the year ended June 30, 2018 (**PHEAA's fiscal year-end**):

Schedule of PHEAA's Proportionate Share of Net Pension Liability
As of and for the years ended December 31 (measurement date)
(Dollars in thousands)

Calendar year end	PHEAA's proportionate (percentage) share of collective net pension liability	PHEAA's proportionate (amount) share of collective net pension liability	PHEAA's covered payroll	PHEAA's proportionate share of collective net pension liability as a percentage of covered payroll	Fiduciary (SERS) net position as a percentage of the total pension liability
2017	**2.39%**	**$413,878**	**$166,194**	**249.0%**	**63.0%**
2016	2.46%	$474,743	$165,462	286.9%	57.8%
2015	2.42%	$440,673	$164,947	267.2%	58.9%
2014	2.18%	$323,866	$141,621	228.7%	64.8%

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

Schedule of PHEAA's Contributions
As of and for the years ended June 30 (PHEAA's fiscal year-end)
(Dollars in thousands)

Fiscal year end	Required contributions	PHEAA's contributions recognized by the pension plan	Contribution excess/(deficiency)	PHEAA's covered payroll	PHEAA's contributions as a percentage of covered payroll
2018	**$46,904**	**$46,904**	**$-**	**$164,133**	**28.6%**
2017	$41,994	$41,994	$-	$169,725	24.7%
2016	$36,074	$36,074	$-	$165,650	21.8%
2015	$26,027	$26,027	$-	$149,629	17.4%

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

OPEB

The schedules that follow are required supplementary information and are presented as of and for the year ended June 30, 2017 (**measurement date**) and as of and for the year ended June 30, 2018 (**PHEAA's fiscal year-end**):

Schedule of PHEAA's Total OPEB Liability
As of and for the years ended June 30 (measurement date)
(Dollars in thousands)

Fiscal year end	PHEAA's total OPEB liability	PHEAA's covered payroll	PHEAA's total OPEB liability as a percentage of covered payroll
2017	**$357,062**	**$119,692**	**298.3%**
2016	387,360	-	-%

The schedule presented above is to illustrate the required 10-year trend of information. However, we are presenting the information for which information was available, because the Commonwealth did not provide all of the information necessary to present a full 10-year trend of information.

Schedule of PHEAA's Contributions
As of and for the years ended June 30 (PHEAA's fiscal year-end)
(Dollars in thousands)

Fiscal year end	Required contributions	PHEAA's contributions recognized by the OPEB plan	Contribution excess/(deficiency)	PHEAA's covered payroll	PHEAA's contributions as a percentage of covered payroll
2018	**$4,062**	**$4,062**	**$-**	**$114,550**	**3.5%**
2017	4,692	4,692	-	119,692	3.9%

The schedule presented above is to illustrate the required 10-year trend of information. However, we are presenting the information for which information was available, because the Commonwealth did not provide all of the information necessary to present a full 10-year trend of information.