Annual Financial Report
June 30, 2019 and 2018

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

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

Building a better working world

Report of Independent Auditors

Management and the Board of Directors
Pennsylvania Higher Education Assistance Agency

Report on the Financial Statements

We have audited the accompanying financial statements of the Pennsylvania Higher Education Assistance Agency (PHEAA), a component unit of the Commonwealth of Pennsylvania, as of and for the years ended June 30, 2019 and 2018, 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, 2019 and 2018, and the results of changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, the required schedules of PHEAA's proportionate share of the net pension liability, PHEAA's contributions, changes in assumptions, and PHEAA's proportionate share of the net Other Postemployment Benefits liability on pages 5 – 30 and 71 – 72 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 19, 2019

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

About PHEAA

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. Creating affordable access to higher education is PHEAA's mission. We have approximately 2,900 employees and contractors, and our principal offices are located in Harrisburg, Pennsylvania.

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 devotes 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"). In addition, Avereo was established to provide technology and core system solutions to other state agencies, educational institutions and the U.S. Department of Education ("ED").

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 ED, the Consumer Financial Protection Bureau ("CFPB"), the Federal Financial Institutions Examination Council, the Commonwealth of Pennsylvania ("Commonwealth" or "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.

Public Service Benefits and Grant Programs

On May 24, 2018, the Board authorized the President/Chief Executive Officer to allocate funds to the following grant programs for fiscal year 2018-2019:

- Pennsylvania State Grant Program - $101.4 million;
- Pennsylvania Targeted Industry Cluster Certificate Scholarship Program - $6.0 million;
- Primary Healthcare Loan Forgiveness Program - $4.5 million; and
- Cheyney University Keystone Academy Program - $0.5 million.

On June 22, 2018, Pennsylvania House Bill No. 2121 (appropriations bill for fiscal year 2018-2019) became law and section 218 allocated funding levels to the following programs for fiscal year 2018-2019:

- Pennsylvania State Grant Program - $273.4 million;
- Institutional Assistance Grant Program - $26.5 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;

- o Horace Mann Bond-Leslie Pickney Hill Scholarship for outreach and recruitment activities at Lincoln and Cheyney Universities Program - $0.7 million;
- o Pennsylvania Internships Program Grants - $0.5 million; and
- o Higher Education of Blind or Deaf Program - $47 thousand.

The following table highlights the disbursements of unrestricted funds for various public service benefits and the 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,	**2019**	2018	2017
Self-funded:			
Pennsylvania State Grant Program Supplement	**$ 70,000**	$ 87,000	$ 87,000
Costs of operating state and federal governmental programs	**13,502**	15,967	16,552
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds	**5,181**	6,141	6,990
Primary Healthcare Loan Forgiveness Program	**4,471**	-	-
Pennsylvania Distance Education Program Supplement, net of refunds	**1,204**	10,339	12,974
Other public service activities and outreach	**2,084**	5,714	3,089
Total self-funded	**$ 96,442**	$ 125,161	$ 126,605

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	**2018-2019**	2017-2018	2016-2017
Maximum grant award	**$4,123**	$4,123	$4,378
Grant recipients (approximate number)	**140,000**	140,000	143,000

- 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 Grant 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, the Board 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,	**2019**	2018	2017
Servicing:			
Commercial servicing:			
Client-owned loans	**$ 28,634,848**	$ 32,081,159	$ 35,955,741
PHEAA and PHEAA Student Loan Trust owned student loans	**3,902,283**	4,594,988	5,030,940
Total commercial servicing	**32,537,131**	36,676,147	40,986,681
FLS servicing	**340,426,501**	320,075,849	295,842,021
Remote servicing:			
Federal servicing	**57,617,602**	47,026,516	38,851,713
Commercial servicing	**23,456,236**	21,552,326	17,079,248
Total remote servicing	**81,073,838**	68,578,842	55,930,961
Total servicing	**454,037,470**	425,330,838	392,759,663
Guaranty:			
Original principal outstanding	**20,487,429**	23,284,875	26,125,091
Inventory of defaulted loans	**3,890,540**	3,917,188	4,103,245
Total guaranty	**24,377,969**	27,202,063	30,228,336
Total assets managed	**$ 478,415,439**	$ 452,532,901	$ 422,987,999

Servicing Activities

We use our proprietary COMPASS system for servicing student loans that we own and loans owned by third parties through our commercial, 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 private student loan programs.

FLS Servicing

Our FLS line of business services FFEL and William D. Ford ("Direct Loan") program loans owned by ED. We are one of four Title IV Additional Servicers ("TIVAS") that service student loans owned by ED. Additionally, ED has contracts with various not-for-profit ("NFP") entities to service student loans. On May 14, 2019, ED's Office of Federal Student Aid ("FSA") exercised an "Option to Extend Service" clause by extending our period of performance from June 16, 2019 to December 15, 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 continues to embark 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, efficient and effective financial solution to leverage in supporting its citizens. On February 20, 2018, FSA posted Phase 1 of the NextGen solution. Phase 1 was part of a two-phase source selection and FSA anticipated utilizing a commercial solution(s) to meet the objectives of this initiative. The submission deadline for Phase 1 was April 18, 2018, and we submitted a timely offer to ED. On September 24, 2018, ED selected PHEAA to participate in Phase II of the NextGen procurement process for certain components. On January 15, 2019, ED canceled certain components of the NextGen procurement and issued several new solicitations for the services covered by those components, using full and open competition procedures. On April 2, 2019, PHEAA submitted a timely offer to ED for the Enhanced Processing Solution portion of the NextGen solution, and on August 2, 2019, PHEAA submitted a timely offer to ED for the Business Process Operations portions of the NextGen solution. PHEAA continues to prepare responses for other components of the NextGen solution as response dates have not been formally released by ED.

Remote Servicing

Our remote servicing line of business provides our COMPASS system to guarantors, 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. Additionally, we have the authority to purchase and finance private student loan portfolios that come up for sale, provided we are the current servicer.

On August 27, 2018, PHEAA's Executive Committee of the Board of Directors authorized the creation and establishment of the PA Forward Private Student Loan Program in order to assist Pennsylvania students, families and schools with higher education tuition costs not covered by grants, scholarships, federal student loans, or other aid. The PA Forward Private Student Loan Program was designed for undergraduates, graduates, parents, and those looking to refinance their student loans. PHEAA launched the PA Forward Private Student Loan Program for undergraduate, graduate and parent loan programs on April 30, 2019.

Guaranty Activities

Our FFEL program 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. The reinsurance rates, based on loan disbursement dates, were as follows:

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

We have established a loan rehabilitation program for all borrowers with an enforceable promissory note. A borrower must meet the following requirements for the loan to be 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.

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.

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

For 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,	**2019**	2018	2017
Student loan interest revenue, net	**$ 171,194**	$ 157,952	$ 143,789
Investment interest revenue	**25,117**	16,051	15,961
Total interest revenue	**196,311**	174,003	159,750
Interest expense on student loan financings, net	**(104,571)**	(72,951)	(37,781)
Interest expense on other financings, net	**(204)**	(348)	(425)
Total interest expense	**(104,775)**	(73,299)	(38,206)
Net interest revenue	**91,536**	100,704	121,544
Provision for loan losses	**(3,435)**	(3,538)	(3,895)
Net interest revenue after provision for loan losses	**88,101**	97,166	117,649
Total noninterest revenue	**448,339**	484,620	519,031
Total operating revenues	**536,440**	581,786	636,680
Total operating expenses	**(494,926)**	(560,308)	(570,923)
Operating income	**41,514**	21,478	65,757
Total grants and financial aid, net	**(87,582)**	(104,326)	(130,436)
Changes in net position	**(46,068)**	(82,848)	(64,679)
Net position, beginning balance (**restated**)	**220,512**	304,364	751,711
Net position, ending balance	**$ 174,444**	$ 221,516	$ 687,032

Student loan interest revenue is net of consolidation loan rebate fees, government interest income, special allowance income or expense, 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, 2018, the beginning net position was restated due to an adjustment to the Agency's proportionate share of the net pension liability. See **Note 4 – Restatement of Net Position** and **Note 10 – Retirement Benefits** for more details.

Statements of Net Position

(Dollars in thousands)

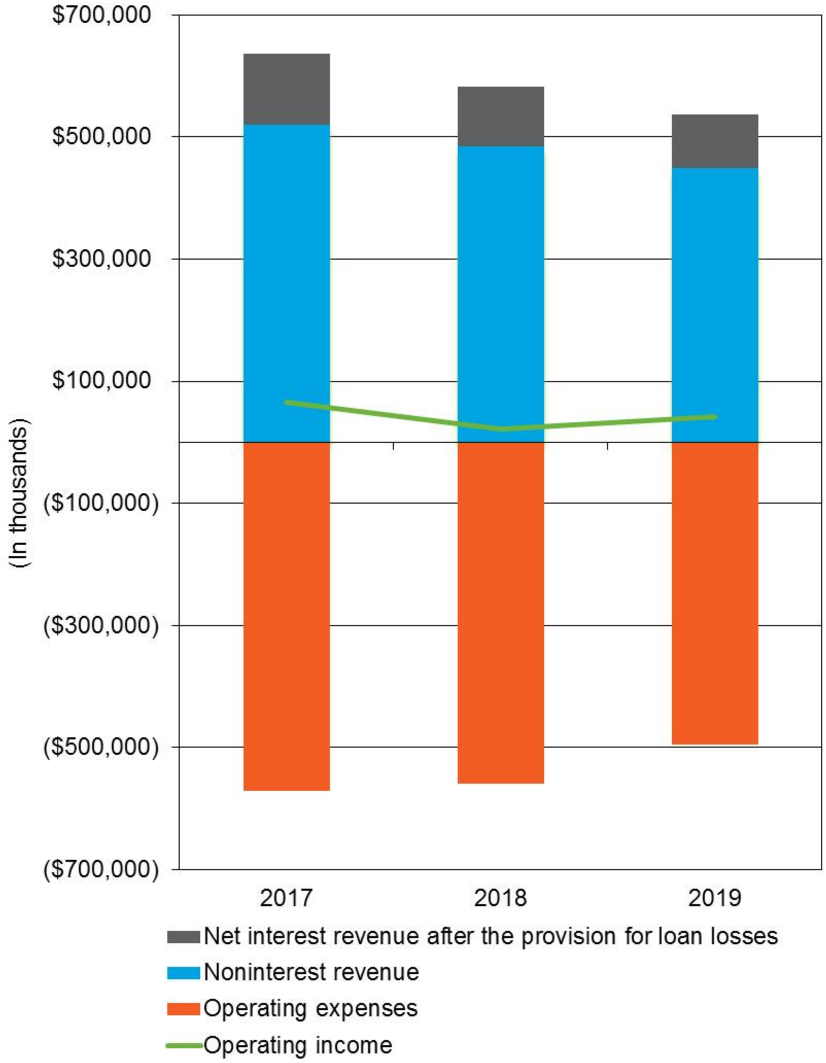
As of June 30,	**2019**	2018	2017
Current assets:			
Cash, cash equivalents and investments (restricted and unrestricted)	**$ 681,824**	$ 749,675	$ 1,097,158
Student loans receivable	**572,934**	752,702	788,882
Other assets	**252,835**	237,487	193,122
Total current assets	**1,507,593**	1,739,864	2,079,162
Long-term assets:			
Student loans receivable, net	**3,318,921**	3,822,546	4,224,277
Capital assets, net	**103,356**	91,025	88,238
Total long-term assets	**3,422,277**	3,913,571	4,312,515
Total assets	**4,929,870**	5,653,435	6,391,677
Total deferred outflow of resources	**104,033**	83,324	134,810
Current liabilities:			
Student loan financings	**40,000**	240,000	200,000
Other liabilities	**249,022**	227,876	257,980
Total current liabilities	**289,022**	467,876	457,980
Long-term liabilities:			
Student loan financings, net	**3,650,100**	4,108,779	4,762,797
Net pension liability	**438,740**	413,878	474,743
Net other postemployment benefit liability	**274,286**	357,062	-
Other liabilities	**19,507**	44,632	49,829
Total long-term liabilities	**4,382,633**	4,924,351	5,287,369
Total liabilities	**4,671,655**	5,392,227	5,745,349
Total deferred inflow of resources	**187,804**	123,016	94,106
Net position:			
Net investment in capital assets	**103,356**	91,025	88,238
Restricted for debt service	**361,176**	341,848	305,780
Restricted for financial aid grant programs	**29,961**	33,035	29,305
Unrestricted	**(320,049)**	(244,392)	263,709
Total net position	**$ 174,444**	$ 221,516	$ 687,032

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

For the years ended June 30,

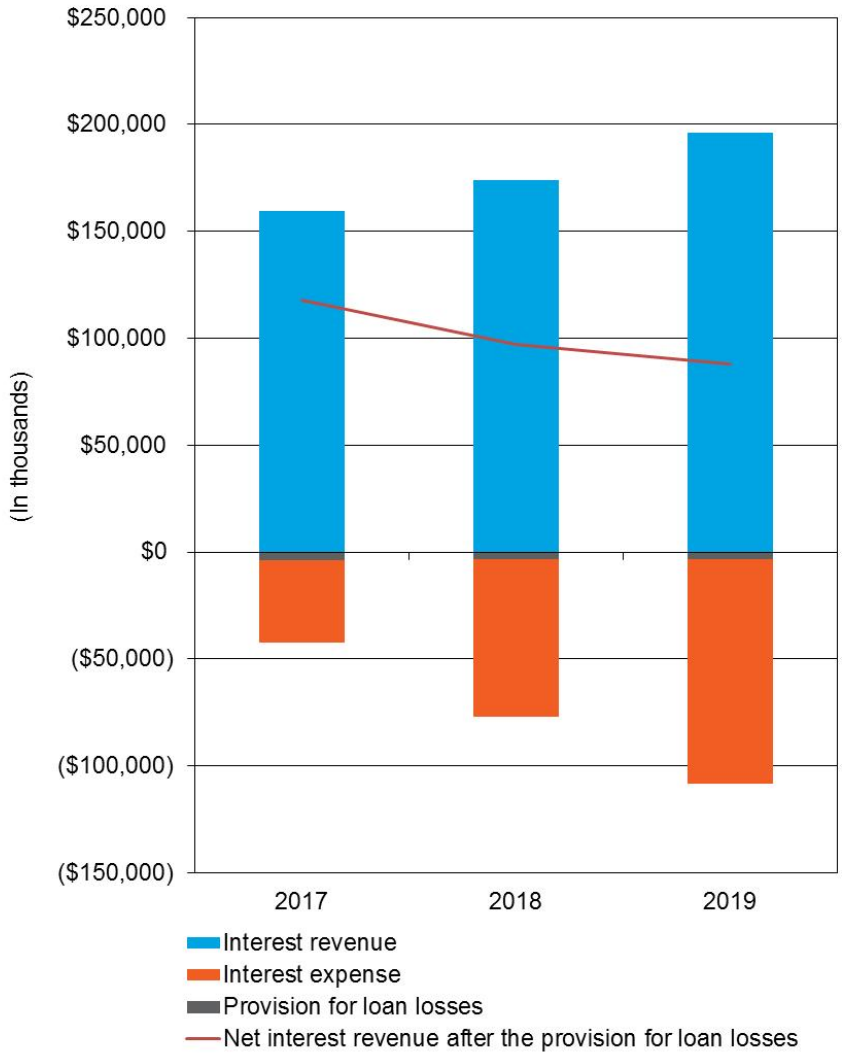


Operating income for the year ended June 30, 2019, was $41.5 million, a 93.0% increase from $21.5 million in 2018. Operating revenues were $536.4 million in 2019, a 7.8% decrease from $581.8 million in 2018. Net interest revenue after the provision for loan losses was $88.1 million in 2019, a 9.4% decrease from $97.2 million in 2018. Noninterest revenue was $448.3 million in 2019, a 7.5% decrease from $484.6 million in 2018. Operating expenses were $494.9 million in 2019, an 11.7% decrease from $560.3 million in 2018.

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.

A more detailed explanation of the results of operations follows.

Net Interest Revenue after the Provision for Loan Losses
For the 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, 2019, net interest revenue after the provision for loan losses was $88.1 million, a 9.4% decrease from $97.2 million in 2018. The decrease was mainly due to our variable rate debt costs increasing 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 (a reduction to student loan interest expense). These decreases were partially offset by the gains earned (realized and unrealized) on our investments in the Commonwealth Treasury Investment Pool and the increase in our special allowance income.

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 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.

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,	**2019**	2018	2017
Interest yield:			
Student loan yield	**4.05%**	3.31%	2.62%
Investment yield	**3.29%**	1.77%	1.54%
Total interest yield	**3.94%**	3.07%	2.45%
Interest rate:			
Student loan financings rate	**(2.58%)**	(1.56%)	(0.69%)
Other financing rate	**(0.88%)**	(1.26%)	(1.32%)
Total interest rate	**(2.57%)**	(1.56%)	(0.69%)
Net interest spread	**1.37%**	1.51%	1.76%
Net interest margin	**1.84%**	1.77%	1.86%
Average balances (in thousands):			
Student loans	**$ 4,223,512**	$ 4,771,800	$ 5,482,467
Investments	**764,460**	904,333	1,038,770
Student loan financings	**4,055,912**	4,673,548	5,480,187
Other financings	**23,119**	27,713	32,231

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, 2019, the 91-day U.S. Treasury Bill rate was used to calculate special allowance for 2% 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 88% 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)	**2019 vs. 2018**			2018 vs. 2017		
		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	$ 13,242	$ 31,391	$ (18,149)	$ 14,163	$ 32,802	$ (18,639)
Investment interest revenue:						
Investment income	4,830	6,914	(2,084)	4,981	6,080	(1,099)
Fair value adjustments	4,236	4,634	(398)	(4,891)	(3,925)	(966)
Total interest revenue	22,308	42,939	(20,631)	14,253	34,957	(20,704)
Student loan financings interest expense, net	31,620	41,261	(9,641)	35,170	40,731	(5,561)
Other financings interest expense, net	(144)	(86)	(58)	(77)	(17)	(60)
Total interest expense	31,476	41,175	(9,699)	35,093	40,714	(5,621)
Net interest revenue	$ (9,168)	$ 1,764	$ (10,932)	$ (20,840)	$ (5,757)	$ (15,083)

2019 vs. 2018 – Changes in Rate and Volume

For the year ended June 30, 2019, 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, 2019, 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. In addition, there was an increase in the rate of the fair value adjustment income due to an increase in the Net Asset Value ("NAV") on our investments in the Commonwealth's Treasury Investment Pool.

For the year ended June 30, 2019, 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.

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 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.

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,	**2019**	2018	2017
Provision for losses	**$ 3,435**	$ 3,538	$ 3,895

For the year ended June 30, 2019, the provision for loan losses was $3.4 million, a 2.9% decrease from $3.5 million in 2018. 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. These decreases in the provision for loan losses were mainly due to reductions in our risk share and our cure reserve provisions as our student loan portfolio continues to run off.

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.

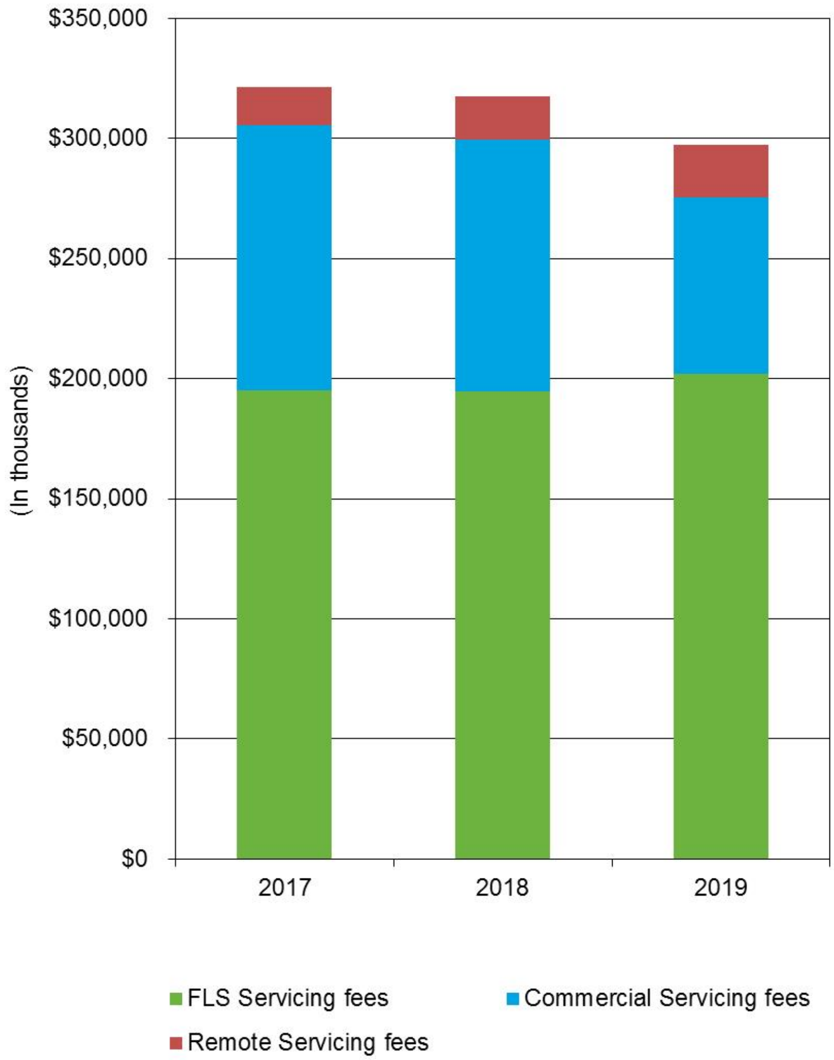
(Dollars in thousands)

For the years ended June 30,	**2019**	2018	2017
Noninterest revenue:			
Servicing fees	**$ 297,477**	$ 317,560	$ 321,350
Retention of collections on defaulted loans, net	**137,327**	146,146	174,538
Federal fees	**14,027**	15,619	17,275
Other	**(492)**	5,295	5,868
Total noninterest revenue	**$ 448,339**	$ 484,620	$ 519,031

For the year ended June 30, 2019, total noninterest revenue was $448.3 million, a 7.5% decrease from $484.6 million in 2018. For the year ended June 30, 2018, total noninterest revenue was $484.6 million, a 6.6% decrease from $519.0 million in 2017.

We provide a more detailed discussion on the changes in total noninterest revenue in the sections that follow.

Servicing Fees
For the years ended June 30,



We earn servicing fee revenue by servicing student loans owned by third parties. We categorize revenue earned from loans owned by 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 COMPASS system to guarantors and other servicers to use, as well as to NFP servicers who were awarded servicing contracts by ED.

For the year ended June 30, 2019, total servicing fees were $297.5 million, a 6.3% decrease from $317.6 million in 2018. The average balance of third party loans serviced on our systems increased to $437.9 billion or 7.7% in 2019 from $406.5 billion in 2018.

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 years ended June 30, 2019 and 2018, the decreases were mainly due to the run-off of the Commercial Servicing loan portfolio, which was partially offset by increases in our FLS Servicing and Remote Servicing loan portfolios.

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 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, 2019, the retention of collections on defaulted loans, net, was $137.3 million, a 6.0% decrease from $146.1 million in 2018. For the year ended June 30, 2019, total collections on defaulted loans, was $825.6 million, a 7.0% decrease from $887.6 million in 2018. The decreases were mainly due to reductions in the total volume of collections on rehabilitated student loans as less borrowers default due to income based repayment options and a decrease in the inventory of eligible loans to be rehabilitated.

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, an 18.2% 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.

Operating Expenses

The following table displays our major categories of operating expenses.

(Dollars in thousands)

For the years ended June 30,	**2019**		2018		2017	
Operating expenses:						
Personnel and benefits	**$ 255,557**	**51.7%**	$ 320,774	57.2%	$ 319,622	56.0%
Professional services	**100,536**	**20.3%**	96,801	17.3%	109,296	19.1%
Information technology related expenses	**62,574**	**12.6%**	62,985	11.2%	59,627	10.5%
Mail services	**21,130**	**4.3%**	24,380	4.4%	27,873	4.9%
Depreciation	**20,914**	**4.2%**	20,045	3.6%	16,758	2.9%
Other	**34,215**	**6.9%**	35,323	6.3%	37,747	6.6%
Total operating expenses	**$ 494,926**	**100.0%**	$ 560,308	100.0%	$ 570,923	100.0%

For the year ended June 30, 2019, operating expenses were $494.9 million, an 11.7% decrease from $560.3 million in 2018. For the year ended June 30, 2018, operating expenses were $560.3 million, a 1.9% decrease from $570.9 million in 2017. In the sections that follow, we discuss changes in personnel and benefits.

Personnel and Benefits

The following table displays personnel and benefits expenses:

(Dollars in thousands)

For the years ended June 30,	**2019**		2018		2017	
Personnel and benefits:						
Compensation	**$ 139,219**	**54.5%**	$ 165,658	51.6%	$ 168,869	52.8%
Pension expense	**62,699**	**24.5%**	66,039	20.6%	79,651	24.9%
Health care benefits for employees and retirees	**32,098**	**12.6%**	35,128	11.0%	37,913	11.9%
Independent contractor fees	**17,286**	**6.7%**	23,657	7.4%	20,144	6.3%
Employer's share of Social Security	**10,999**	**4.3%**	12,271	3.8%	12,270	3.7%
Capitalized software development costs	**(4,080)**	**(1.6%)**	(4,194)	(1.3%)	(5,727)	(1.7%)
Other postemployment benefits expense	**(4,107)**	**(1.6%)**	20,693	6.4%	4,692	1.5%
Other	**1,443**	**0.6%**	1,522	0.5%	1,810	0.6%
Total personnel and benefits	**$ 255,557**	**100.0%**	$ 320,774	100.0%	$ 319,622	100.0%

For the year ended June 30, 2019, personnel and benefits costs were $255.6 million, a 20.3% decrease from $320.8 million in 2018. 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.

Compensation

For the year ended June 30, 2019, compensation expense was $139.2 million, a 16.0% decrease from $165.7 million in 2018. The decrease was mainly due to reductions in personnel, our annual and sick leave accruals, and overtime, which were partially offset by a contractually required 2.5% union pay raise and a 2.25% non-union pay raise.

Pension Expense

For the year ended June 30, 2019, pension expense was $62.7 million, a 5.0% decrease from $66.0 million in 2018. For the year ended June 30, 2018, pension expense was $66.0 million, a 17.2% decrease from $79.7 million in 2017. The decreases were mainly due to changes in the total pension liability of the Commonwealth's pension plan and our covered employee payroll, which these changes directly affected our proportionate share of collective pension expense.

Independent Contractor Fees

For the year ended June 30, 2019, independent contractor fees were $17.3 million, a 27.0% decrease from $23.7 million in 2018. The decrease was mainly due to us reducing the number of independent contractors used in our internal audit and digital technology solutions divisions. For the year ended June 30, 2018, independent contractor fees were $23.7 million, a 17.9% increase from $20.1 million in 2017. The increase was mainly due to independent contractors used within the internal audit and digital technology solutions divisions.

Other Postemployment Benefits ("OPEB") Expense

For the year ended June 30, 2019, OPEB expense was a negative $4.1 million, a 119.8% change from $20.7 million in 2018. PHEAA records its proportionate share of the Commonwealth OPEB liability. The Commonwealth experienced lower than expected increases in the Retired Employees Health Plan ("REHP") claim payments and lower than expected increases in the fully insured rates. The result of these actuarial differences reduced the Commonwealth's overall OPEB liability, which directly affected our proportionate share of the net OPEB liability, deferred inflows and outflows and 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. This increase in OPEB expense was due to the adoption of GASB Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* (GASB 75).

Grants and Financial Aid, net

The following table shows the grants and financial aid, net:

(Dollars in thousands)

For the years ended June 30,	2019	2018	2017
Commonwealth of Pennsylvania grants	**$ 333,212**	$ 333,560	$ 334,695
Federal grants	**1,620**	1,598	1,608
Grants and other financial aid, net of refunds	**(422,414)**	(439,484)	(466,739)
Total grants and financial aid, net	**$ (87,582)**	$(104,326)	$(130,436)

Commonwealth of Pennsylvania Grants

For the year ended June 30, 2019, Commonwealth of Pennsylvania grants were $333.2 million, a 0.1% decrease from $333.6 million in 2018. 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 Commonwealth of Pennsylvania grants were mostly consistent with the prior year.

Grants and Other Financial Aid Activity, net of refunds

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

(Dollars in thousands)

For the years ended June 30,	2019	2018	2017
Grants and other financial aid activity, net of refunds:			
Pennsylvania State Grant Program, net of refunds	**$ 350,392**	$ 357,606	$ 384,669
Institutional Assistance Grant Program, net of refunds	**26,478**	25,742	26,285
Matching Funds Program, net of refunds	**12,483**	12,504	11,813
Pennsylvania National Guard Education Assistance Program, net of refunds	**10,236**	11,278	13,140
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program, net of refunds	**5,181**	6,141	6,990
Pennsylvania Ready to Succeed Scholarship Program, net of refunds	**5,121**	4,963	5,077
Primary Healthcare Loan Forgiveness, net of refunds	**4,259**	4,492	209
Higher Education for the Disadvantaged, net of refunds	**2,270**	2,236	2,006
Pennsylvania Distance Education Program, net of refunds	**1,204**	10,339	12,974
Other programs, net of refunds	**4,790**	4,183	3,576
Total grants and other financial aid, net of refunds	**$ 422,414**	$ 439,484	$ 466,739

For the year ended June 30, 2019, grants and other financial aid, net of refunds, were $422.4 million, a 3.9% decrease from $439.5 million during 2018. For the year ended June 30, 2018, grants and other financial aid, net of refunds, were $439.5 million, a 5.8% decrease from $466.7 million during 2017. The changes in grants and other financial aid, net of refunds, were primarily due to the timing of funds disbursed from the various grant programs.

Student Loans Receivable, net

In the table below, we present our student loans receivable, net.

(Dollars in thousands)

As of June 30,	**2019**	2018	2017
Student loans receivable:			
FFEL student loans:			
Consolidation	**$ 3,168,376**	$ 3,674,455	$ 4,057,477
Stafford	**654,414**	816,667	849,572
PLUS	**49,726**	66,904	75,457
SLS	**1,109**	711	812
Total FFEL student loans	**3,873,625**	4,558,737	4,983,318
Private and HEAL student loans:			
Private	**18,964**	16,531	20,133
HEAL	**6,646**	11,920	19,103
Total private and HEAL student loans	**25,610**	28,451	39,236
Total student loans receivable	**3,899,235**	4,587,188	5,022,554
Unamortized student loan purchase premium	**1,778**	3,431	5,559
Unamortized student loan purchase discount	**(4,332)**	(9,240)	(8,308)
Allowance for loan losses	**(4,826)**	(6,131)	(6,646)
Total student loans receivable, net	**$ 3,891,855**	$ 4,575,248	$ 5,013,159

As of June 30, 2019, student loans receivable, net were $3.9 billion, a 15.2% decrease from $4.6 billion in 2018. As of June 30, 2018, student loans receivable, net, were $4.6 billion, an 8.0% decrease from $5.0 billion in 2017. The decreases in student loans receivable, net, were mainly due to borrower payments, claims and consolidation payoffs. For the year ended June 30, 2019, the decrease in student loans receivable, net as noted above was partially offset by purchases of student loans from third party financial institutions.

Delinquencies have the potential to adversely affect earnings through increased collection costs and charge-offs/write-offs. The June 30, 2019 table that follows 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, $2.1 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, 2019	**FFEL**		**Non-FFEL**		**Total**	
Loans in-school/in-grace	**$ 1,738**		**$ 22**		**$ 1,760**	
Loans in:						
Deferment	**190,721**		**600**		**191,321**	
Forbearance	**320,132**		**187**		**320,319**	
Total loans in-school/in-grace, and deferment and forbearance	**512,591**		**809**		**513,400**	
Loans in repayment:						
Current	**3,086,911**	**91.8%**	**23,689**	**96.1%**	**3,110,600**	**92.0%**
31 – 60 days	**92,411**	**2.8%**	**265**	**1.1%**	**92,676**	**2.7%**
61 – 90 days	**53,436**	**1.6%**	**56**	**0.2%**	**53,492**	**1.6%**
91 – 120 days	**24,716**	**0.7%**	**107**	**0.4%**	**24,823**	**0.7%**
121 – 180 days	**39,175**	**1.2%**	**130**	**0.5%**	**39,305**	**1.2%**
181 – 270 days	**39,347**	**1.2%**	**-**	**0.0%**	**39,347**	**1.2%**
271 days or greater	**15,150**	**0.5%**	**46**	**0.2%**	**15,196**	**0.4%**
Claims filed not paid	**7,841**	**0.2%**	**379**	**1.5%**	**8,220**	**0.2%**
Total loans in repayment	**3,358,987**	**100.0%**	**24,672**	**100.0%**	**3,383,659**	**100.0%**
Total student loans	**$ 3,871,578**		**$ 25,481**		**$ 3,897,059**	

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	256,258		897		257,155	
Forbearance	400,244		298		400,542	
Total loans in-school/in-grace, 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%
Total student loans	$ 4,556,319		$ 28,162		$ 4,584,481	

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 allowance 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 are 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, 2019, 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,	**2019**	2018	2017
Balance at beginning of year	**$ 5,776**	$ 6,295	$ 16,599
Provision for losses	**3,703**	3,323	3,228
Charge-offs/Write-offs	**(4,870)**	(3,842)	(13,532)
Balance at end of year	**$ 4,609**	$ 5,776	$ 6,295
Ending balance of student loans	**$ 3,873,625**	$ 4,558,737	$ 4,983,318
Allowance as a percentage of ending balance of student loans	**0.12%**	0.13%	0.13%

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,	**2019**	2018	2017
Balance at beginning of year	**$ 355**	$ 351	$ 4,630
Provision for losses	**(268)**	215	667
Charge-offs/Write-offs	**130**	(211)	(4,946)
Balance at end of year	**$ 217**	$ 355	$ 351
Ending balance of student loans	**$ 25,610**	$ 28,451	$ 39,236
Allowance as a percentage of ending balance of student loans	**0.85%**	1.25%	0.89%

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,	2019	2018	2017
Land	**$ 8,044**	$ 8,038	$ 8,038
Software, net (purchased and developed)	**53,315**	38,110	30,326
Buildings and improvements, net	**26,362**	29,630	31,664
Information technology equipment, net	**12,064**	10,648	12,018
Other equipment, net	**3,571**	4,599	6,192
Total capital assets, net	**$ 103,356**	$ 91,025	$ 88,238

As of June 30, 2019, capital assets, net of accumulated depreciation and amortization, were $103.4 million, a 13.6% increase from $91.0 million as of June 30, 2018. The increase in capital assets, net of accumulated depreciation and amortization, was mainly due to increases in purchased software related to our information technology transformation projects, which was partially offset by the depreciation and amortization of capital assets.

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.

See **Note 8 – Capital Assets, net** for more details.

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,	2019	2018	2017
Deferred outflow of resources:			
Deferred loss on bond refundings	**$ 1,967**	$ 2,345	$ 841
Current liabilities:			
Student loan financings	**40,000**	240,000	200,000
Other financings	**-**	4,230	4,055
Long-term liabilities:			
Student loan financings, net	**3,650,100**	4,108,779	4,762,797
Other financings, net	**6,965**	21,377	26,099
Deferred inflow of resources:			
Deferred gain on bond refundings	**14,472**	42,007	82,247

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, 2019, our outstanding debt, excluding our blended component units, the deferred gain and loss on bond refundings, and premiums and discounts on bonds, amounted to $0.5 billion, which was below the 20% threshold mentioned above. The blended component units are excluded from this threshold, because their debt was not issued by PHEAA. As of June 30, 2019, the outstanding debt of our blended component units was $3.2 billion, which was related to the student loan trusts. See **Note 15 – Blended Component Units** for more details on the student loan trusts.

The following table shows the proceeds and repayment activity of our debt.

(Dollars in thousands)

As of June 30,	**2019**	2018	2017
Capital market activity:			
Proceeds from issuing student loan floating rate notes	**$ 426,700**	$ -	$ 925,568
Repayment of student loan floating rate notes	**(640,331)**	(741,341)	(873,723)
Repayment of student loan auction rate security bonds	**(1,990)**	(164,359)	(45,050)
Student loan financing activity:			
Proceeds from student loan financings	**-**	461,932	-
Repayment of student loan financings	**(445,986)**	(175,946)	(738,213)
Other financing activity:			
Repayment of capital acquisition refunding bonds	**(18,245)**	(4,055)	(3,895)

2019 Debt Activity

Capital Market Activity and Student Loan Financing Activity

For the year ended June 30, 2019, the $426.7 million of the student loan floating rate note proceeds were due to the PHEAA Student Loan Trust 2018-1 bond issuance on October 29, 2018. For the year ended June 30, 2019, the $642.3 million repayment of capital market activity was due to debt payments.

The $446.0 million repayment of student loan financings were due to debt payments.

Other Financing Activity

During the year ended June 30, 2019, the $18.2 million in other financing activity repayments was due to the in-substance defeasance of the Capital Acquisition Refunding Bonds, Series of 2012.

2018 Debt Activity

Capital Market Activity and 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 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 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 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 debt 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.

Net Position

The following table shows our restricted and unrestricted net position.

(Dollars in thousands)

As of June 30,	**2019**	2018	2017
Net investment in capital assets	**$ 103,356**	$ 91,025	$ 88,238
Restricted for debt service	**361,176**	341,848	305,780
Restricted for financial aid grant programs	**29,961**	33,035	29,305
Unrestricted	**(320,049)**	(244,392)	263,709
Total net position	**$ 174,444**	$ 221,516	$ 687,032

<u>Net Investment in Capital Assets</u>

As of June 30, 2019, the net investment in capital assets was $103.4 million, a 13.6% increase from $91.0 million as of June 30, 2018. 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 increases in the net investment in capital assets were mainly due to increases in purchased software related to our information technology transformation projects, which were partially offset by the depreciation and amortization of capital assets.

<u>Restricted for Debt Service</u>

As of June 30, 2019, we had net position restricted for debt service of $361.2 million, a 5.7% increase from $341.8 million as of June 30, 2018. The increase in net position restricted for debt service was due to $39.1 million of operating income restricted for debt service, which was partially offset by $19.8 million of transfers to unrestricted net position.

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.

See **Note 14 - Segment Information** for more details.

<u>Restricted for Financial Aid Grant Programs</u>

As of June 30, 2019, we had net position restricted for financial aid grant programs of $30.0 million, a 9.1% decrease from $33.0 million as of June 30, 2018. 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 changes in net position restricted for financial aid grant programs were mainly due to the timing of allocated grant funds received from the Commonwealth and the disbursement of grant funding.

Unrestricted

As of June 30, 2019, we had unrestricted net position of a negative $320.0 million, a 30.9% change from a negative $244.4 million as of June 30, 2018. The change in unrestricted net position was due to an unrestricted operating loss of $0.5 million, $74.9 million of transfers to net position restricted for financial aid grant programs (Pennsylvania State Grant Program, Primary Healthcare Loan Forgiveness Program and Cheyney Keystone Academy Program), $6.6 million of net grant disbursements and $12.4 million of funds transferred to the net investment in capital assets, which were offset by $19.8 million of funds transferred from net position restricted for debt service. The balance as of June 30, 2018 was restated by $1.0 million due to an adjustment to the Agency's proportionate share of the net pension liability. See **Note 4 – Restatement of Net Position** and **Note 10 – Retirement Benefits** for more details.

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, Primary Healthcare Loan Forgiveness Program and Cheyney Keystone Academy Program), $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.

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,	**2019**	2018	2017
Additions:			
Reinsurance from the U.S. Department of Education	**$ 843,090**	$ 857,534	$ 937,958
Collections on defaulted loans	**653,035**	734,884	978,340
Net appreciation in the fair value of investments	**308**	219	144
Total additions	**1,496,433**	1,592,637	1,916,442
Deductions:			
Purchases of defaulted loans from lenders	**841,395**	855,416	934,470
Reimbursement to U.S. Department of Education for federal share of defaulted loans collections	**503,384**	565,154	743,708
Reimbursement to PHEAA for our retention of defaulted loans collections	**139,162**	154,555	203,123
Default aversion fees, net	**1,249**	4,908	7,920
Other	**27**	-	-
Total deductions	**1,485,217**	1,580,033	1,889,221
Net increase	**11,216**	12,604	27,221
Net liabilities, beginning of period	**(132,674)**	(145,278)	(172,499)
Net liabilities, end of period	**$ (121,458)**	$ (132,674)	$ (145,278)

For the year ended June 30, 2019, reinsurance from ED was $843.1 million, a 1.7% decrease from $857.5 million in 2018. For the year ended June 30, 2019, purchases of defaulted loans were $841.4 million, a 1.6% decrease from $855.4 million in 2018. The decreases were due to a reduction in borrowers entering into default with third party lenders.

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, purchases of defaulted loans were $855.4 million, an 8.5% decrease from $934.5 million in 2017. These decreases were due to the decline in the collections on defaulted loans.

For the year ended June 30, 2019, collections on defaulted loans were $653.0 million, a 11.1% decrease from $734.9 million in 2018. For the year ended June 30, 2019, reimbursement to ED for the federal share of defaulted loans collections was $503.4 million, a 10.9% decrease from $565.2 million in 2018. The decreases were due to the decline in the inventory of eligible loans to be rehabilitated.

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, 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. These decreases were due to the decline in the total volume of rehabilitation loans as more borrowers enter into income based repayment options, and avoid default.

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, 2019**	As of September 30, 2018
Generally accepted accounting principles – net assets	**$ (121,458)**	$ (130,405)
Default aversion fees payable to PHEAA, but not transferred from the Federal Fund to PHEAA	**190,960**	190,960
Gain contingency – collections complement on future default collections	**32,258**	66,422
Gain contingency – default aversion fee rebate payable from PHEAA to the Federal Fund	**9,296**	9,561
Regulatory net assets	**$ 111,056**	$ 136,538
Original principal outstanding	**$ 20,487,429**	$ 22,637,042
Federal reserve ratio	**0.54%**	0.60%
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

September 19, 2019

(Dollars in thousands)

	2019	2018
Operating revenues:		
Interest revenue:		
Student loans, net	**$ 171,194**	$ 157,952
Investments	**25,117**	16,051
Total interest revenue	**196,311**	174,003
Interest expense:		
Student loan financings, net	**104,571**	72,951
Other financings, net	**204**	348
Total interest expense	**104,775**	73,299
Net interest revenue	**91,536**	100,704
Provision for loan losses	**(3,435)**	(3,538)
Net interest revenue after provision for loan losses	**88,101**	97,166
Noninterest revenue:		
Servicing fees	**297,477**	317,560
Retention of collections on defaulted loans, net	**137,327**	146,146
Federal fees	**14,027**	15,619
Other	**(492)**	5,295
Total noninterest revenue	**448,339**	484,620
Total operating revenues	**536,440**	581,786
Operating expenses:		
Personnel and benefits	**255,557**	320,774
Professional services	**100,536**	96,801
Information technology related expenses	**62,574**	62,985
Mail services	**21,130**	24,380
Depreciation	**20,914**	20,045
Other	**34,215**	35,323
Total operating expenses	**494,926**	560,308
Operating income	**41,514**	21,478
Grants and financial aid:		
Commonwealth of Pennsylvania grants	**333,212**	333,560
Federal grants	**1,620**	1,598
Grants and other financial aid, net of refunds	**(422,414)**	(439,484)
Total grants and financial aid, net	**(87,582)**	(104,326)
Changes in net position	**(46,068)**	(82,848)
Net position, beginning of period (**restated**)	**220,512**	304,364
Net position, end of period	**$ 174,444**	$ 221,516

See accompanying notes to the financial statements.

(Dollars in thousands)

	2019	2018
Assets:		
Current assets:		
Cash and cash equivalents	**$ 103,576**	$ 64,452
Restricted cash and cash equivalents	**153,097**	150,745
Restricted cash and cash equivalents – due to customers	**61,978**	78,015
Investments	**334,483**	424,641
Restricted investments	**28,690**	31,822
Student loans receivable	**572,934**	752,702
Interest income receivable	**94,530**	94,585
Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net	**82,009**	69,539
Due from Federal Student Loan Reserve Fund, net	**12,508**	11,287
Other assets	**63,788**	62,076
Total current assets	**1,507,593**	1,739,864
Long-term assets:		
Student loans receivable, net	**3,318,921**	3,822,546
Capital assets, net	**103,356**	91,025
Total long-term assets	**3,422,277**	3,913,571
Total assets	**4,929,870**	5,653,435
Deferred outflow of resources:		
Deferred outflows of resources related to pensions	**98,343**	76,917
Deferred outflows of resources related to other postemployment benefits	**3,723**	4,062
Deferred loss on bond refundings	**1,967**	2,345
Total deferred outflow of resources	**104,033**	83,324
Liabilities:		
Current liabilities:		
Accounts payable and accrued expenses	**167,013**	154,107
Student loan financings	**40,000**	240,000
Amounts related to the Federal Student Loan Reserve Fund	**82,009**	69,539
Other financings	**-**	4,230
Total current liabilities	**289,022**	467,876
Long-term liabilities:		
Student loan financings, net	**3,650,100**	4,108,779
Net pension liability	**438,740**	413,878
Net other postemployment benefit liability	**274,286**	357,062
Other financings, net	**6,965**	21,377
Accrued expenses	**12,542**	23,255
Total long-term liabilities	**4,382,633**	4,924,351
Total liabilities	**4,671,655**	5,392,227
Deferred inflow of resources:		
Deferred gain on bond refundings	**14,472**	42,007
Deferred inflows of resources related to pensions	**52,362**	34,549
Deferred inflows of resources related to other postemployment benefits	**120,906**	46,299
Deferred gain on sales leaseback	**64**	161
Total deferred inflow of resources	**187,804**	123,016
Net position:		
Net investment in capital assets	**103,356**	91,025
Restricted for debt service	**361,176**	341,848
Restricted for financial aid grant programs	**29,961**	33,035
Unrestricted	**(320,049)**	(244,392)
Total net position	**$ 174,444**	$ 221,516

See accompanying notes to the financial statements.

(Dollars in thousands)

	2019	2018
Cash flows from operating activities:		
Interest received on student loans	**$ 118,145**	$ 65,684
Principal received on student loans	**674,018**	824,140
Student loan originations	**(52)**	-
Student loan purchases	**(468,516)**	(811,452)
Student loan sales, including net gains and losses	**527,272**	493,645
Servicing fees	**297,793**	301,149
Retention of collections on defaulted loans	**136,037**	149,519
Federal fees	**14,447**	16,045
Default aversion fee rebates	**68**	542
Other	**(1,615)**	273
Payment of operating expenses	**(436,865)**	(537,301)
Net cash provided by operating activities	**860,732**	502,244
Cash flows from noncapital financing activities:		
Proceeds from issuance of noncapital debt	**426,700**	461,932
Principal paid on noncapital debt	**(1,106,552)**	(1,085,701)
Interest paid on noncapital debt	**(130,695)**	(107,740)
Bond issuance costs	**(6,097)**	(333)
Commonwealth of Pennsylvania grants received	**333,212**	333,560
Federal grants received	**1,620**	1,598
Grants and financial aid paid	**(422,414)**	(439,484)
Net cash used in noncapital financing activities	**(904,226)**	(836,168)
Cash flows from capital and related financing activities:		
Purchases of capital assets and development of software, net of disposals	**(33,342)**	(22,931)
Net cash used in capital and related financing activities	**(33,342)**	(22,931)
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	**750,803**	776,163
Purchases of investments	**(650,700)**	(656,413)
Interest received on investments	**18,209**	13,373
Net cash provided by investing activities	**118,312**	133,123
Net change in cash and cash equivalents (including restricted cash)	**41,476**	(223,732)
Cash and cash equivalents (including restricted cash), beginning of period	**215,197**	438,929
Cash and cash equivalents (including restricted cash), end of period	**$ 256,673**	$ 215,197

(continued)

Statements of Cash Flows
For the years ended June 30,
(Dollars in thousands)

	2019	2018
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	**$ 41,514**	$ 21,478
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	**20,914**	20,045
Interest paid on noncapital debt	**130,694**	107,740
Investment interest	**(25,117)**	(16,051)
Bond issuance costs	**6,097**	333
Pension expense valuation adjustment	**20,244**	19,135
Other postemployment benefit expense valuation adjustment	**(7,830)**	16,631
Amortization of premium on loan purchases	**1,653**	2,128
Amortization of gain and loss on bond refunding	**(26,867)**	(39,435)
Amortization of discount on bonds payable	**2,638**	3,387
Amortization of premium on other financings	**(397)**	(491)
Changes in assets and liabilities:		
Decrease (increase) in interest income receivable	**150**	(21,585)
Decrease in student loans receivable	**681,740**	435,783
(Increase) decrease in amounts due from Federal Student Loan Reserve Fund	**(1,221)**	3,725
Increase in other assets	**(1,712)**	(17,520)
Increase (decrease) in accounts payable and accrued expenses	**18,232**	(33,059)
Total adjustments	**819,218**	480,766
Net cash provided by operating activities	**$ 860,732**	$ 502,244

See accompanying notes to the financial statements.

Note 1 – About PHEAA

Organization

The Pennsylvania Higher Education Assistance Agency ("PHEAA" or "Agency"), doing business as American Education Services ("AES"), FedLoan Servicing ("FLS") and Avereo, 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" or "Pennsylvania") 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 ("Governor") 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 15 - Blended Component Units**.

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 of America 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, because 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 receivable 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 loans 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 student loans – We record a provision for loan losses on private student loans when the student loan payment status is no longer current (payments are more than 120 days past due), borrowers that are expected to default or non-performing.
    - The student loans formerly guaranteed by The Education Resource Institute, Inc. ("TERI") are included with the private loans. We record a provision on 100% of the TERI student loan balances that have a payment delinquency status of 121 days and greater, and those loans classified as "claims filed but not paid".

    - The student loans associated with Pennsylvania nursing schools and the Health Education Assistance Loan ("HEAL") supplemental student loans are included with the private student 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 or 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. As a result, upgrades and enhancements are typically capitalized. 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 an 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, ("HEA") 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 HEA. 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 loan 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 FFEL program 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 Student Loan Reserve Fund ("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 HEA.

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, the PHEAA Student Loan Trust 2018-1 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. 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 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. On July 1, 2018, we adopted and implemented GASB 88 and there was no material impact to the financial results.

Note 4 – Restatement of Net Position

On July 1, 2018, the beginning total and unrestricted net position were decreased by $1.0 million due to a change in the Agency's proportionate share of the net pension liability as of the measurement date of December 31, 2017. In the table that follows, we present the impact of this increase in net pension liability. See **Note 10 – Retirement Benefits** for more details.

(Dollars in thousands)

Statement of Revenue, Expenses and Changes in Net Position	
Total net position, beginning of period, July 1, 2018 (as reported)	$ 221,516
Increase in net pension liability	(1,004)
Total net position, beginning of period, July 1, 2018 (**restated**)	$ 220,512
Unrestricted net position, beginning of period, July 1, 2018 (as reported)	$ (244,392)
Increase in net pension liability	(1,004)
Unrestricted net position, beginning of period, July 1, 2018 (**restated**)	$ (245,396)

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,	**2019**	2018
Assets:		
Cash	**$ 21,350**	$ 16,461
Receivable from the U.S. Department of Education	**61,873**	53,354
Other receivables	**788**	757
Total assets	**84,011**	70,572
Liabilities:		
Accounts payable and accrued expenses	**2,002**	1,033
Amounts payable to PHEAA	**203,467**	202,213
Total liabilities	**205,469**	203,246
Net liabilities	**$ (121,458)**	$ (132,674)

Under 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, 2019 and 2018, we reported $82.0 million and $69.5 million, respectively, in the line item “Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net” in the Statements of Net Position, which is the difference between the Federal Fund’s total assets and accounts payable and accrued expenses, excluding amounts payable to PHEAA.

Note 6 – Cash, Cash Equivalents and Investments

Overview

We manage our portfolio of cash, cash equivalents and investments in such a manner to ensure 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.

Carrying Value

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,	**2019**	2018
Cash and cash equivalents	**$ 103,576**	$ 64,452
Restricted cash and cash equivalents	**153,097**	150,745
Restricted cash and cash equivalents – due to customers	**61,978**	78,015
Investments	**334,483**	424,641
Restricted investments	**28,690**	31,822
Total carrying value	**$ 681,824**	$ 749,675

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. As of June 30, 2019 and 2018, the Agency had no Level 3 investments.

The following tables show the fair value and the fair value measurements for our cash equivalents and investments.

(Dollars in thousands)

As of June 30, 2019	**Carrying Value**	**Fair Value**	**Level 1**	**Level 2**
Cash equivalents:				
Money market funds:				
Federated money market funds	**$ 145,474**	**$ 145,474**	**$ 145,474**	**$ -**
PFM Government Select Series	**55,211**	**55,211**	**-**	**55,211**
Federal agency discount notes	**55,844**	**55,922**	**-**	**55,922**
Commercial paper	**46,793**	**47,058**	**-**	**47,058**
Total cash equivalents	**303,322**	**303,665**	**145,474**	**158,191**
Investments:				
State Treasury investment pools:				
Pool 998	**162,525**	**162,525**	**-**	**-**
Pool 999	**200,648**	**200,648**	**-**	**-**
Total investments	**363,173**	**363,173**	**-**	**-**
Total cash equivalents and investments	**$ 666,495**	**$ 666,838**	**$ 145,474**	**$ 158,191**

(Dollars in thousands)

As of June 30, 2018	Carrying Value	Fair Value	Level 1	Level 2
Cash equivalents:				
Money market funds:				
Federated money market funds	$ 139,866	$ 139,866	$ 139,866	$ -
PFM Government Select Series	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	257,841	257,988	139,866	118,122
Investments:				
State Treasury investment pools:				
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

Cash Equivalents

Money Market Funds

Federated Money Market Funds – As of June 30, 2019 and 2018, we held positions in various Federated money market funds and the fair values of those funds were $145.5 million and $139.9 million, respectively. The fair values of the Federated money market funds were valued using quoted market prices (Level 1).

PFM Government Select Series – As of June 30, 2019 and 2018, we held positions in PFM Government Select Series and the fair values were $55.2 million and $54.8 million, respectively. The fair values of the PFM Government Select 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, 2019 and 2018, we held positions in federal agency discounted notes and the fair values were $55.9 million and $24.3 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, 2019 and 2018, we held positions in commercial paper and the fair values were $47.1 million and $39.0 million, respectively. The fair values of the commercial paper were based on a market approach using quoted prices by a third party for markets that are not active (Level 2).

Investments

State Treasury Investment Pools

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, 2018 (most recent annual report available), Pool 998's asset allocations were 65% invested in fixed income (including cash and cash equivalents) and 35% invested in equities and alternative assets. Pool 998 is benchmarked against a blend of indexes. 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 ICE Bank of America Merrill Lynch 6-Month U.S. Treasury Bill Index. The alternative portion of Pool 998's investments is measured against HFRI Fund of Funds Composite Index. As of June 30, 2019 and 2018, our investments in Pool 998 were $162.5 million and $151.9 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, 2018 (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 ICE Bank of America Merrill Lynch 91 Day U.S. Treasury Bill Index. As of June 30, 2019 and 2018, our investments in Pool 999 were $200.6 million and $304.5 million, respectively.

For more information on Pools 998 and 999, see the Pennsylvania Treasury "Annual Investment Report for Fiscal Year Ended June 30, 2018", which can be found at www.patreasury.gov.

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, 2019 and 2018, $303.3 million and $257.8 million, respectively, of our cash equivalents have maturities of less than one year. As of June 30, 2019 and 2018, $363.2 million and $456.5 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, 2019 and 2018, all of our investments in commercial paper were rated at least A-1. As of June 30, 2019 and 2018, all of our investments in money market funds were rated AAAm. As of June 30, 2019 and 2018, the investments in the State Treasury investment pools were 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, 2019, we had $14.8 million of cash deposits with financial institutions of which $14.6 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, 2019, our investment in federal agency discount notes (FHLB) represented 8.4% of our total cash equivalents and investments. As of June 30, 2018, 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,	**2019**	2018
FFEL student loans:		
Consolidation	**$ 3,168,376**	$ 3,674,455
Stafford	**654,414**	816,667
PLUS	**49,726**	66,904
SLS	**1,109**	711
Total FFEL student loans	**3,873,625**	4,558,737
Private and HEAL student loans:		
Private	**18,964**	16,531
HEAL	**6,646**	11,920
Total private and HEAL student loans	**25,610**	28,451
Total student loans receivable	**3,899,235**	4,587,188
Unamortized student loan purchase premium	**1,778**	3,431
Unamortized student loan purchase discount	**(4,332)**	(9,240)
Allowance for loan losses	**(4,826)**	(6,131)
Total student loans receivable, net	**$ 3,891,855**	$ 4,575,248

Allowance for Loan Losses

The following table summarizes the allowance for loan losses. The “provision for losses – FFEL program loans” and the “provision for losses - other program loans (Non-FFEL)” are reported as the “provision for loan losses” in the Statements of Revenues, Expenses and Changes in Net Position.

(Dollars in thousands)

As of June 30,	**2019**	2018
Balance at beginning of year	**$ 6,131**	$ 6,646
Provision for losses - FFEL program loans	**3,703**	3,323
Provision for losses - Other program loans (Non-FFEL)	**(268)**	215
Charge-offs - FFEL program loans	**(4,870)**	(3,842)
Charge-offs - Other program loans (Non-FFEL)	**130**	(211)
Balance at end of year	**$ 4,826**	$ 6,131

Note 8 – Capital Assets, net

The following table shows an analysis of the capital asset activity.

(Dollars in thousands)

As of and for the year ended June 30, 2019	Beginning Balance	Additions	Retirements	Ending Balance
Capital assets:				
Land	$ 8,038	$ 6	$ -	$ 8,044
Buildings and improvements	76,016	483	(2,307)	74,192
Software	74,591	30,764	(11,581)	93,774
Information technology equipment	26,044	5,661	(2,811)	28,894
Other equipment	18,246	297	(1,808)	16,735
Total capital assets	202,935	37,211	(18,507)	221,639
Less accumulated depreciation and amortization for:				
Buildings and improvements	(46,386)	(2,019)	575	(47,830)
Software	(36,480)	(13,528)	9,549	(40,459)
Information technology equipment	(15,397)	(4,041)	2,608	(16,830)
Other equipment	(13,647)	(1,326)	1,809	(13,164)
Total accumulated depreciation and amortization	(111,910)	(20,914)	14,541	(118,283)
Total capital assets, net	$ 91,025	$ 16,297	$ (3,966)	$ 103,356

Depreciation expense for the years ended June 30, 2019 and 2018 was $20.9 million and 20.0 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, 2019	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due within One Year
Student loan financings:					
Student loan floating rate notes, due 2028-2068 at weighted-average rates of 3.14% as of June 30, 2019 and 2.89% as of June 30, 2018	$ 3,858,602	$ 426,700	$ (640,331)	$ 3,644,971	$ -
Deferred gain on bond refunding of student loan floating rate notes	42,007	63	(27,598)	14,472	-
Deferred loss on bond refunding of student loan floating rate notes	(2,345)	668	(290)	(1,967)	-
Discount on student loan floating rate notes	(6,909)	2,638	-	(4,271)	-
Student loan auction rate security bonds due 2042, at interest rate of 3.34% as of June 30, 2019 and a weighted-average interest rate of 2.55% as of June 30, 2018	11,100	-	(1,700)	9,400	-
Student loan financings warehouse facilities, unused portion was $250.0 million as of June 30, 2019	245,986	-	(245,986)	-	-
Student loan financings, due on demand, at an an interest rate of 3.24% as of June 30, 2019 and 2.83% as of June 30, 2018. Unused portion was $200.0 million as of June 30, 2019.	240,000	-	(200,000)	40,000	40,000
Total student loan financings	4,388,441	430,069	(1,115,905)	3,702,605	40,000
Other financings:					
Capital acquisition refunding bonds, Series of 2012, due 2019-2022.	18,245	-	(18,245)	-	-
Unamortized premium on capital acquisition refunding bonds	1,082	-	(397)	685	-
Term financings, due 2029, at zero percent as of June 30, 2019 and June 30, 2018.	6,280	-	-	6,280	-
Total other financings	25,607	-	(18,642)	6,965	-
Total student loan and other financings	$ 4,414,048	$ 430,069	$ (1,134,547)	$ 3,709,570	$ 40,000

The notes and bond indentures, among other things, require us to comply with various covenants, such as parity ratio requirements and annual financial statement, servicing audits. Student loans and investments collateralize all student loan financings. As of June 30, 2019, $3.9 billion of student loan principal and related interest receivable and $151.9 million of cash equivalents collateralized the $3.7 billion of student loan financings.

As of June 30, 2019, the student loan financings and other financings are non-recourse obligations to our unrestricted net position and to the Commonwealth, except for the $40.0 million of student loan financings, which are recourse obligations to us.

Student Loan Financings

For the year ended June 30, 2019, the student loan financings had a net decrease of $685.8 million that was primarily due to debt payments of $1.1 billion, and scheduled amortization of deferred gains and losses on bond refundings and scheduled amortization of discounts on student loan floating rate notes of $24.5 million, which were partially offset by the PHEAA Student Loan Trust 2018-1 bond issuance of $426.7 million.

PHEAA Student Loan Trust 2018-1

On October 9, 2018, the Foundation entered into a trust agreement with a financial institution that created the PHEAA Student Loan Trust 2018-1 (“2018-1 Trust”) and on that same date the 2018-1 Trust was formed as a statutory trust under the Delaware Statutory Act, 12 *Del. C*. Section 3801, *et seq*. The principal purpose of the 2018-1 Trust is to securitize student loans and student loan related assets, to acquire student loans from the Foundation and issue one or more classes of securities secured by a pledge of such assets.

On October 29, 2018, the 2018-1 Trust issued $141.5 million of original principal amount of student loan asset backed notes, Class A-1, at par, and $285.2 million of original principal amount of student loan asset back notes, Class A-2, at par. The Class A-1 notes were issued with an interest rate of 1-month LIBOR plus 0.30% with a final maturity date of October 25, 2068. The Class A-2 notes were issued with an interest rate of 1-month LIBOR plus 0.77% with a final maturity date of October 25, 2068.

On that same day, we used the proceeds from the above bond issuance to pay down the student loan financings and the warehouse facilities.

Other Financings

On April 10, 2019, PHEAA, through a financial advisor, purchased $14.6 million of open-market Treasury securities to fund the escrow associated with the in-substance defeasance of the Capital Acquisition Refunding Bonds, Series of 2012 (Refunding Bonds). PHEAA could not purchase United States Treasury Securities, State and Local Government Series (SLGS), because the United States Treasury Department suspended the sale of SLGS on March 1, 2019. The open-market Treasury securities were placed into an escrow account that was established through an Escrow Agent with a third-party financial institution. The open-market Treasury securities have maturity dates that coincide with the principal and interest due dates of the Refunding Bonds. The Refunding Bonds have a stated maturity date of December 15, 2022 and are subject to an optional redemption on or after December 15, 2020.

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
2020	$ 40,000	$ 115,027	$ -	$ -
2021	-	114,920	-	-
2022	-	114,920	-	-
2023	-	114,920	-	-
2024	-	114,920	-	-
2025-2029	29,649	573,041	-	-
2030-2034	108,626	554,446	6,280	-
2035-2039	1,054,668	491,136	-	-
2040-2044	1,362,801	291,556	-	-
2045-2049	30,250	176,593	-	-
2050-2054	-	174,758	-	-
2055-2059	123,683	167,080	-	-
2060-2064	-	156,488	-	-
2065-2069	944,694	60,540	-	-
	$3,694,371	$3,220,345	$ 6,280	$ -

The student loan financings are variable-rate debt, which have interest rates that reset on various dates. As of June 30, 2019, interest rates on $9.4 million reset based upon auctions every 28 days and $3.7 billion was indexed to the 1-month or 3-month LIBOR.

Note 10 – Retirement Benefits

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" 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.

On June 12, 2017, Governor Wolf signed Act 2017-5 into law. The law established two new side-by-side hybrid defined benefit/defined contribution benefit options (Classes A-5 and A-6) and a new defined contribution only (straight 401(a)DC) option for all state employees, excluding most hazardous duty employees, who first enter SERS membership on or after January 1, 2019. Additionally, all current SERS members will have a one-time, irrevocable option to select one of the three new retirement benefit options between January 1, 2019, and March 31, 2019. The newly elected option will be effective July 1, 2019, and generally will apply to all future service.

The Class A-5 hybrid plan is for all non-exempt groups who default/remain in Class A-5. The Class A-5 members contribute 8.25% of their salary of which 5.0% is for the defined benefit plan and 3.25% is for the defined contribution plan. The annual benefit rate is 1.25% of pay for each year worked. The vesting period is 10 years for the defined benefits and 3 years for the defined contribution benefit.

The Class A-6 hybrid plan is for all non-exempt groups who elect in Class A-6. The Class A-6 members contribute 7.5% of their salary of which 4.0% is for the defined benefit plan and 3.5% is for the defined contribution plan. The annual benefit rate is 1.0% of pay for each year worked. The vesting period is 10 years for the defined benefits and 3 years for the defined contribution benefit.

The retirement age for the Class A-5 and A-6 members is 67 with three years of service or Rule 97 with 35 eligibility points.

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.

For the year ended June 30, 2019, the employer contribution rates were 27.71% for the “A” Class of Service employees, 34.63% for the “AA” Class of Service employees and 23.94% for the “A-3” and “A-4” Class of Service employees. 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.

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.

SERS Implementation of GASB 75

During the year ended December 31, 2018, SERS implemented GASB 75. GASB specifies the required approach to measuring the Other Postemployment Benefits (“OPEB”) liability for employers for benefits provided through the Retired Employees Health Program (“REHP”). This required SERS to record its proportionate share of net OPEB liability, as of a determined date, and restate its net position restricted for pensions as of January 1, 2018, thereby increasing the 2017 net pension liability previously reported. PHEAA’s share of the SERS’ restatement was $1.0 million as of July 1, 2018. See **Note 4 – Restatement of Net Position.** A revised GASB 68 Valuation was not prepared for the measurement date of December 31, 2017. Therefore, in the following sections, the June 30, 2018 data is for information prior to the restatement for GASB 75.

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 2019-2020 and 2018-2019 fiscal years, from the December 31, 2018 and 2017 funding valuation, to the expected funding payroll for the allocation of the calendar year 2018 and 2017 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, 2019	
Projected contributions, July 1, 2019 through June 30, 2020	**$ 46,088**
Total projected contributions, July 1, 2019 through June 30, 2020	**$ 2,188,240**
Employer allocation percentage	**2.11%**

(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%

Proportionate Share of Net Pension Liability

As of June 30, 2019, the net pension liability was measured as of December 31, 2018, 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, 2018, 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. The SERS valuation measurement dates of December 31, 2018 and 2017 were not the same as PHEAA's fiscal years end of June 30, 2019 and 2018, respectively.

The following table presents the calculation of our proportionate share of net pension liability as of June 30, 2019 and 2018. 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,	**2019**	2018
SERS collective net pension liability	**$ 20,831,021**	$ 17,291,709
PHEAA's allocation percentage	**2.11%**	2.39%
PHEAA's proportionate share of net pension liability	**$ 438,740**	$ 413,878

<u>Assumptions and Other Inputs</u>

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 of directors, 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 the summer 2019, and will be used for its 2019 annual valuation.

The following methods and assumptions were used in the GASB 68 Valuation for the December 31, 2018 and 2017 measurement dates:

- Actuarial cost method – entry age
- 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%	7.25%
Global public equity	48.00%	5.15%
Real estate	12.00%	5.26%
Multi-strategy	10.00%	4.44%
Fixed income	11.00%	1.26%
Cash	3.00%	0.00%
Total	100.00%	

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, 2019 and 2018, 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%
2019	**$ 538,737**	**$ 438,740**	**$ 353,048**
2018	$ 525,340	$ 413,878	$ 318,398

GASB 68 Employer Amounts

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

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

(Dollars in thousands) As of June 30,	**2019**	2018
Deferred outflows of resources:		
Differences between expected and actual experience	**$ 6,584**	$ 6,998
Net difference between projected and actual investment earnings on pension plan investments	**42,687**	-
Changes in assumptions	**11,689**	20,721
Differences between employer contributions and proportionate share of contributions	**1,939**	300
Changes in proportion	**12,760**	24,025
Contributions made subsequent to the measurement date	**22,684**	24,873
Total deferred outflows of resources	**$ 98,343**	$ 76,917

(Dollars in thousands) As of June 30,	**2019**	2018
Deferred inflows of resources:		
Differences between expected and actual experience	**$ 4,754**	$ 7,858
Net difference between projected and actual investment earnings on pension plan investments	**-**	16,456
Differences between employer contributions and proportionate share of contributions	**332**	655
Changes in proportion	**47,276**	9,580
Total deferred inflows of resources	**$ 52,362**	$ 34,549

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 5.3 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 Agency's contributions subsequent to the measurement date will be recorded as a reduction to the pension liability during the year ending June 30, 2020. The remaining net amounts of deferred outflows of resources and deferred inflows of resources related to the items previously reported as of June 30, 2019 will be recognized in pension expense in future years as follows:

(Dollars in thousands)

For the years ending June 30,	2020	2021	2022	2023	2024	Thereafter
Net amortization	$ 21,004	$ 2,118	$ (3,682)	$ 6,328	$ (2,471)	$ -

Pension Expense

The components of the Agency's proportionate share of total pension expense are as follows:

(Dollars in thousands)

As of June 30,	**2019**	2018
Pension expense:		
Proportionate share of plan pension expense	**$ 62,865**	$ 57,306
Net amortization difference between employer contributions and proportionate share of contributions	**146**	(252)
Net amortization of deferred amounts from changes in proportion	**(312)**	8,985
Total pension expense	**$ 62,699**	$ 66,039

Note 11 – 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 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. Plan assets are restricted for use for the provision and administration of REHP retirees' health benefits. Employers maintain no rights and ownership to the assets and the trust. 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". 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. The REHP is reported using the economic resources measurement focus and the accrual basis of accounting. The Commonwealth's CAFR 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. Employer contributions made to the REHP Trust are irrevocable. 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 $300 during the first half of the fiscal year and $188 during the second half of the year per bi-weekly pay period for each current REHP eligible active employee during fiscal year ended June 30, 2018 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, 2019 and 2018, PHEAA's contributions were $3.7 million and $4.1 million, respectively. As of June 30, 2019 and 2018, 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.

PHEAA's Allocation Percentage Methodology

For entities that contribute at the same employer health assessment rate, their proportionate share is based on current year contractually required contributions. For the one Commonwealth agency and three component units that participated under contribution terms unique to their agencies, which includes PHEAA, the proportionate share is based on their subset demographics' total OPEB liability. As of June 30, 2019 and 2018, PHEAA's allocation percentage was 1.868% and 1.780%, respectively.

Proportionate Share of Net OPEB Liability

As of June 30, 2019, the net OPEB liability was measured as of June 30, 2018, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. As of June 30, 2018, the net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. The OPEB valuation measurement dates of June 30, 2018 and 2017 were not the same as PHEAA's fiscal years end of June 30, 2019 and 2018, respectively.

The following table presents the calculation of our proportionate share of net OPEB liability as of June 30, 2019 and 2018. 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 OPEB liability".

(Dollars in thousands)

As of June 30,		**2019**		2018
REHP collective net OPEB liability	**$**	**14,682,127**	$	20,054,335
PHEAA's allocation percentage		**1.87%**		1.78%
PHEAA's proportionate share of net OPEB liability	**$**	**274,286**	$	357,062

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, 2018 and 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, 2017 for June 30, 2018 measurement date and December 31, 2016 for June 30, 2017 measurement date
- Discount rate – 3.87% as of June 30, 2018 and 3.58% as of June 30, 2017
- Inflation – 2.60%
- Investment rate of return – 5.0%
- Medical trend rate – initial - $6.2%/5.9%, ultimate – 4.1%, year reached – 2075 as of June 30, 2018 and initial – 6.0%, ultimate – 3.9%, year reached 2075 as of June 30, 2017

- 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%	6.6%
International Equity	20.0%	8.6%
Fixed Income	25.0%	3.0%
Real Estate	8.0%	6.9%
Cash and cash equivalents	-	1.0%
Total	100.00%	

Sensitivity of PHEAA's Proportionate Share of Net OPEB Liability to Changes in the Discount and Medical Trend Rates

The following table presents our proportionate share of the net OPEB liability calculated using the discount rate of 3.87% and the medical trend rate of 4.10% as of June 30, 2019, as well as the impact on the net 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	Current Rate	1% increase
As of June 30, 2019 - Discount rate – 3.87%	**$ 314,237**	**$ 274,286**	**$ 241,368**
As of June 30, 2019 – Medical trend rate – 4.10%	**$ 235,451**	**$ 274,286**	**$ 322,553**

The following table presents our proportionate share of the net OPEB liability calculated using the discount rate of 3.58% and the medical trend rate of 3.90% as of June 30, 2018, as well as the impact on the net 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	Current 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

GASB 75 Employer Amounts

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

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

(Dollars in thousands)

As of June 30,	**2019**	2018
Deferred outflows of resources:		
Contributions made subsequent to the measurement date	**$ 3,723**	$ 4,062
Total deferred outflows of resources	**$ 3,723**	$ 4,062

The Agency's contributions made subsequent to the measurement date will be recorded as a reduction to the OPEB liability during the year ending June 30, 2020.

(Dollars in thousands)

As of June 30,	**2019**	2018
Deferred inflows of resources:		
Changes in assumptions	**$ 36,057**	$ 46,299
Differences between expected and actual experience	**84,007**	-
Net difference between projected and actual investment earnings on OPEB plan investments	**419**	-
Change in proportionate share and differences between actual and proportionate share of employer contributions	**423**	-
Total deferred inflows of resources	**$ 120,906**	$ 46,299

Amortization of Deferred Inflows of Resources

The components of deferred inflows of resources, other than the net difference between projected and actual investment earnings on OPEB plan investments, are amortized into OPEB expense over 5.74 years. The net difference between projected and actual investment earnings on OPEB plan investments are amortized into OPEB expense over 5.0 years.

The components of the deferred inflows of resources as of June 30, 2019 will be recognized in OPEB expense in future years as follows:

(Dollars in thousands)

For the years ending June 30,	2020	2021	2022	2023	2024	Thereafter
Deferred inflows of resources	$ (27,047)	$ (27,047)	$ (27,047)	$ (24,903)	(14,687)	$ (175)

OPEB Expense

For the years ended June 30, 2019 and 2018, the Agency's OPEB expense was a negative $4.1 million and $20.7 million, respectively.

Note 12 – Net Position

Net investment in capital assets 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, 2019 and 2018, net investment in capital assets was $103.4 million and $91.0 million, respectively.

We have net position restricted for debt service held under various indentures related to the financing of our student loan portfolios. As of June 30, 2019 and 2018, net position restricted for debt service was $361.2 million and $341.8 million, respectively.

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, 2019 and 2018, net position restricted for financial aid grant programs was $30.0 million and $33.0 million, respectively.

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, 2019, unrestricted net position was a negative $320.0 million of which net position related to the guaranty activities was $122.6 million. As of June 30, 2018, unrestricted net position was a negative $244.4 million of which net position related to the guaranty activities was $91.7 million.

Note 13 – 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". 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 years ended June 30, 2019 and 2018, total servicing revenues were $297.5 million and $317.6 million, respectively. For the years ended June 30, 2019 and 2018, we were servicing on average $362.0 billion and $343.4 billion, respectively, of loans for third party customers. For the years ended June 30, 2019 and 2018, customers using our servicing systems serviced on average $75.9 billion and $63.1 billion, respectively, of loans.

For the year ended June 30, 2019, ED provided $201.9 million of servicing revenue, which represents 67.9% of the total servicing revenue. The next three loan-servicing customers provided $31.7 million of servicing revenue, which represents 10.7% of the total servicing revenue.

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.

Note 14– Segment Information

Our Student Loan segment generally finances student loan portfolios by issuing notes, bonds, and other financings. We are reporting condensed financial information about the Student Loan segment, because we pledge the earnings to support the debt. 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,	**2019**	2018
Interest revenue	**$ 171,854**	$ 158,010
Interest expense	**(104,432)**	(72,951)
Net interest revenue	**67,422**	85,059
Provision for loan losses	**(2,598)**	(2,884)
Net interest revenue after provision for loan losses	**64,824**	82,175
Total noninterest revenue	**178**	963
Total operating revenues	**65,002**	83,138
Total operating expenses	**(25,886)**	(27,383)
Operating income	**39,116**	55,755
Transfers to unrestricted net position	**(19,788)**	(19,687)
Change in net position	**19,328**	36,068
Net position, beginning of period	**341,848**	305,780
Net position, end of period	**$ 361,176**	$ 341,848

Statements of Net Position

(Dollars in thousands)

As of June 30,	**2019**	2018
Current assets:		
Restricted cash and cash equivalents	**$ 151,934**	$ 145,992
Student loans receivable	**587,769**	734,942
Interest income receivable	**89,695**	89,978
Total current assets	**829,398**	970,912
Long-term assets:		
Student loans receivable, net	**3,244,503**	3,770,836
Total long-term assets	**3,244,503**	3,770,836
Total assets	**4,073,901**	4,741,748
Deferred outflow of resources:		
Deferred loss on bond refundings	**1,706**	2,345
Total deferred outflow of resources	**1,706**	2,345
Current liabilities:		
Accounts payable and accrued expenses	**9,859**	11,459
Student loan financings	**40,000**	240,000
Total current liabilities	**49,859**	251,459
Long-term liabilities:		
Student loan financings, net	**3,650,100**	4,108,779
Total long-term liabilities	**3,650,100**	4,108,779
Total liabilities	**3,699,959**	4,360,238
Deferred inflow of resources:		
Deferred gain on bond refundings	**14,472**	42,007
Total deferred inflow of resources	**14,472**	42,007
Net position:		
Restricted for debt service	**361,176**	341,848
Total net position	**$ 361,176**	$ 341,848

Statements of Cash Flows

(Dollars in thousands)

For the years ended June 30,	2019	2018
Cash flows from operating activities:		
Interest received on student loans	**$ 119,652**	$ 67,612
Principal received on student loans	**691,544**	813,247
Student loan originations	**(52)**	-
Student loan purchases	**(49,993)**	(449,050)
Student loan sales, including net gains and losses	**78,689**	187,027
Other	**178**	83
Payment of operating expenses	**(22,575)**	(37,469)
Net cash provided by operating activities	**817,443**	581,450
Cash flows from noncapital financing activities		
Proceeds from issuance of noncapital debt	**426,700**	461,932
Principal paid on noncapital debt	**(1,088,018)**	(1,081,646)
Interest paid on noncapital debt	**(129,879)**	(106,853)
Bond issuance costs	**(3,828)**	(333)
Other	**(19,788)**	(19,687)
Net cash used for noncapital financing activities	**(814,813)**	(746,587)
Cash flows from investing activities		
Interest received on investments	**3,312**	2,140
Net cash provided by investing activities	**3,312**	2,140
Net change in restricted cash and cash equivalents	**5,942**	(162,997)
Restricted cash and cash equivalents, beginning of period	**145,992**	308,989
Restricted cash and cash equivalents, end of period	**$ 151,934**	$ 145,992

There are nineteen separate trusts with parity ratios, a ratio of assets to liabilities, and two of the nineteen trusts have minimum parity ratio requirements. As of June 30, 2019, the two trusts complied with the minimum parity ratio requirements.

Note 15 – 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, the PHEAA Student Loan Trust 2018-1 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,	**2019**	2018
Interest revenue	**$ 147,178**	$ 131,978
Interest expense	**(87,825)**	(56,248)
Net interest revenue	**59,353**	75,730
Provision for loan losses	**(2,800)**	(2,295)
Net interest revenue after provision for loan losses	**56,553**	73,435
Noninterest revenue	**29**	-
Total operating expenses	**(22,463)**	(22,612)
Operating income	**34,119**	50,823
Transfers to unrestricted net position	**(18,698)**	(21,261)
Change in net position	**15,421**	29,562
Net position, beginning of period	**246,504**	216,942
Net position, end of period	**$ 261,925**	$ 246,504

Statements of Net Position

(Dollars in thousands)

As of June 30,	**2019**	2018
Current assets:		
Restricted cash and cash equivalents	**$ 92,183**	$ 102,587
Student loans receivable	**529,340**	596,125
Interest income receivable	**81,831**	79,350
Total current assets	**703,354**	778,062
Long-term assets:		
Student loans receivable, net	**2,801,096**	3,113,660
Total long-term assets	**2,801,096**	3,113,660
Total assets	**3,504,450**	3,891,722
Total deferred outflow of resources	**1,706**	636
Current liabilities:		
Accounts payable and accrued expenses	**6,508**	6,948
Student loan financings	**-**	245,986
Total current liabilities	**6,508**	252,934
Long-term liabilities:		
Student loan financings, net	**3,223,251**	3,350,913
Total long-term liabilities	**3,223,251**	3,350,913
Total liabilities	**3,229,759**	3,603,847
Total deferred inflow of resources	**14,472**	42,007
Net position:		
Restricted for debt service	**261,925**	246,504
Total net position	**$ 261,925**	$ 246,504

Statements of Cash Flows

(Dollars in thousands)

For the years ended June 30,	**2019**	2018
Net cash provided by operating activities	**$ 496,459**	$ 622,630
Net cash used for noncapital financing activities	**(509,236)**	(668,173)
Net cash provided by investing activities	**2,373**	1,453
Net change in restricted cash and cash equivalents	**(10,404)**	(44,090)
Restricted cash and cash equivalents, beginning of period equivalents	**102,587**	146,677
Restricted cash and cash equivalents, end of period equivalents	**$ 92,183**	$ 102,587

Note 16 – 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, and 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.

The Agency is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Agency purchases commercial insurance for all risks of loss including cyber liability for those risks related to computer crimes. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

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 $92.0 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 entering judgment in favor of the Agency. On January 8, 2019, the United States Court of Appeals for the Fourth Circuit affirmed the Final Order entering judgment in favor of the Agency. Dr. Oberg did not ask the Supreme Court of the United States to review the judgment, and this matter is now fully resolved. As of June 30, 2019, and through the date of this report, no loss contingency exists.

Commonwealth of Massachusetts

As a larger participant defined by the Consumer Financial Protection Bureau (the "CFPB"), in the market for student loan servicing, we are the subject of various subpoenas, requests, and actions by various state and federal regulatory bodies. On August 23, 2017, the Commonwealth of Massachusetts ("Massachusetts"), by and through its Attorney General, brought 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, 2019 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, 2019 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, 2018 (**measurement date**) and as of and for the year ended June 30, 2019 (**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
2018	**2.11%**	**$ 438,740**	**$ 154,364**	**284.2%**	**56.4%**
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%

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
2019	**$ 42,455**	**$ 42,455**	**$ -**	**$ 146,491**	**29.0%**
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 schedules presented above are required to illustrate 10-year trend information. However, until we can compile a full 10-year trend of information, we are presenting the information for which information was available.

Changes in Assumptions

The investment rate of return changed from 7.50% as of June 30, 2016 to 7.25% as of June 30, 2017. In addition, the inflation rate changed from 2.75% as of June 30, 2016 to 2.60% as of June 30, 2017.

OPEB

The schedules that follow are required supplementary information and are presented as of and for the year ended June 30, 2018 (**measurement date**) and as of and for the year ended June 30, 2019 (**PHEAA's fiscal year-end**):

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

Fiscal year end	PHEAA's proportionate (percentage) share of collective net OPEB liability	PHEAA's proportionate (amount) share of collective net OPEB liability	PHEAA's covered payroll	PHEAA's proportionate share of collective net OPEB liability as a percentage of covered payroll	Fiduciary (REHP) net position as a percentage of the total OPEB liability
2018	**1.87%**	**$ 274,286**	**$ 114,550**	**239.4%**	**2.2%**
2017	1.78%	$ 357,062	$ 119,692	298.3%	1.4%
2016	-	$ 387,360	-	-	0.9%

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
2019	**$ 3,723**	**$ 3,723**	**$ -**	**$ 102,897**	**4.4%**
2018	$ 4,062	$ 4,062	$ -	$ 114,550	3.5%
2017	$ 4,692	$ 4,692	$ -	$ 119,692	3.9%

The schedules presented above are required to illustrate 10-year trend information. However, until we can compile a full 10-year trend of information, we are presenting the information for which information was available.

Changes in Assumptions

The discount rate changed from 3.58% as of June 30, 2018 to 3.87% as of June 30, 2019. In addition, the medical trend information was updated.

The discount rate changed from 2.85% as of June 30, 2017 to 3.58% as of June 30, 2018.