# Annual Financial Report
# June 30, 2020 and 2019

PHEAA conducts its student loan servicing operations nationally as FedLoan Servicing and American Education Services. PHEAA operates its digital technology division as Avereo.

Ernst & Young LLP
1201 Wills St., Ste. 310
Baltimore, MD 21231

# 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, 2020 and 2019, 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, 2020 and 2019, 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 – 27 and 64 – 65 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 17, 2020

The 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 the Pennsylvania Higher Education Assistance Agency's (PHEAA or Agency) 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 the Agency 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. The Agency has approximately 2,600 employees and contractors, and the 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 and federally 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 FedLoan Servicing (FLS) and American Education Services (AES). PHEAA operates its digital technology division as Avereo.

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 the 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.

The Agency's business activities are subject to regulation and supervision by the U.S. Department of Education (ED), the Consumer Financial Protection Bureau, the Federal Financial Institutions Examination Council, the Commonwealth of Pennsylvania (Commonwealth or Pennsylvania), and various authorities in the states in which it conducts business. In addition, the Agency's activities are subject to audit by the Pennsylvania Department of the Auditor General. The Agency is required to present its financial condition to the Governor and the Legislature by providing an annual report at the end of the Commonwealth's fiscal year.

## Public Service Benefits and Grant Programs

The Commonwealth appropriates funding annually to certain student financial aid programs. PHEAA administers these programs. In addition, in order to support the Agency's mission, PHEAA uses unrestricted earnings to help fund student loan grant programs and to provide 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.

Approved Grant Funding

On June 20, 2019, the Board authorized the President/Chief Executive Officer to allocate up to $30.0 million to the Pennsylvania State Grant Program and $0.5 million to the Cheyney University Keystone Academy Program for fiscal year 2019-2020.

On June 28, 2019, Pennsylvania House Bill No. 790 (appropriations bill for fiscal year 2019-2020) became law and section 218 allocated funding levels to the following programs for fiscal year 2019-2020:

- Pennsylvania State Grant Program - $310.7 million;
- Institutional Assistance Grant Program - $26.5 million;
- Matching Payments for Student Aid Program - $13.1 million;
- Pennsylvania Targeted Industry Program - $6.3 million;
- Pennsylvania Ready to Succeed Scholarship Program - $5.6 million;
- Cheyney University Keystone Academy Program - $3.5 million;

- Higher Education for the Disadvantaged Program - $2.4 million;
- Horace Mann Bond-Leslie Pickney Hill Scholarship Programs - $0.8 million;
- Pennsylvania Internship Program Grants - $0.5 million; and
- Higher Education of Blind or Deaf Students Program - $49 thousand.

Due to the COVID-19 pandemic, the Commonwealth received federal stimulus funding through the Coronavirus Aid, Relief, and Economic Security (CARES) Act. On May 29, 2020, Pennsylvania Senate Bill No. 1108 (COVID-19 Emergency Supplement) became law and section 216 allocated additional funding levels to the following grant programs:

- Pennsylvania State Grant Program - $30.0 million;
- Institutional Assistance Grant Program - $5.0 million;
- Higher Education for the Disadvantaged Program - $5.0 million.

In addition, an allocation of $2.2 million was awarded to PHEAA that allowed certain CARES Act benefits to be extended to Pennsylvania student borrowers. For certain PHEAA owned private student loans, the loan interest rate was waived and payments were suspended as borrowers were placed in an automatic forbearance status for the period of March 13, 2020 through September 30, 2020.

Public Service Support

The following table highlights the Agency's unrestricted funds that were disbursed for various public service benefits and the expenses incurred by the Agency in operating state and federal programs as well as public service activities.

(Dollars in thousands)

| For the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Self-funded: | | | |
| Pennsylvania State Grant Program Supplement | **$ 15,000** | $ 70,000 | $ 87,000 |
| Costs of operating state and federal governmental programs | **12,132** | 13,502 | 15,967 |
| Pennsylvania Distance Education Program Supplement, net of refunds | **(74)** | 1,204 | 10,339 |
| Pennsylvania Targeted Industry Program Supplement, net of refunds | **-** | 5,181 | 6,141 |
| Other public service activities and outreach | **1,888** | 6,555 | 5,714 |
| Total self-funded | **$ 28,946** | $ 96,442 | $ 125,161 |

Commonwealth Supported Student Financial Aid Programs

PHEAA administers the following Commonwealth supported student financial aid programs, among others, to help students pursue higher education:

- 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.

  The following table presents 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 | **2019-2020** | 2018-2019 | 2017-2018 |
|---|---|---|---|
| Maximum grant award | **$ 4,123** | $ 4,123 | $ 4,123 |
| Grant recipients (approximate number) | **133,000** | 140,000 | 140,000 |

- The Institutional Assistance Grant (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 Payments for Student Aid 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 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.

## Operations

To serve Pennsylvanians effectively, the Agency operates inside and outside of Pennsylvania. The Agency's primary operations involve servicing activities, student loan holdings and guaranty activities. The following table displays the total assets managed by the Agency.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Servicing: | | | |
| Commercial servicing: | | | |
| Client-owned loans | **$ 25,861,206** | $ 28,634,848 | $ 32,081,159 |
| PHEAA and PHEAA Student Loan Trust owned student loans | **3,431,731** | 3,902,283 | 4,594,988 |
| Total commercial servicing | **29,292,937** | 32,537,131 | 36,676,147 |
| FLS servicing | **355,109,160** | 340,426,501 | 320,075,849 |
| Remote servicing: | | | |
| Federal servicing | **69,225,257** | 57,617,602 | 47,026,516 |
| Commercial servicing | **26,313,247** | 23,456,236 | 21,552,326 |
| Total remote servicing | **95,538,504** | 81,073,838 | 68,578,842 |
| Total servicing | **479,940,601** | 454,037,470 | 425,330,838 |
| Guaranty: | | | |
| Original principal outstanding | **18,133,777** | 20,487,429 | 23,284,875 |
| Inventory of defaulted loans | **3,575,561** | 3,890,540 | 3,917,188 |
| Total guaranty | **21,709,338** | 24,377,969 | 27,202,063 |
| Total assets managed | **$ 501,649,939** | $ 478,415,439 | $ 452,532,901 |

Servicing Activities

The Agency services student loans that are owned by PHEAA or by third parties through its commercial, FLS, and remote servicing lines of business. The Agency's proprietary COMPASS system is used to service student loans. COMPASS is a mainframe-based decision support tool utilized by Agency personnel, as well as, by 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***

The commercial servicing line of business includes servicing of student loans owned by the Agency and loans owned by third parties that were originated under the Federal Family Education Loan (FFEL) program prior to July 1, 2010, and various private student loan programs.

***FLS Servicing***

The FLS line of business services FFEL and William D. Ford (Direct Loan) program loans owned by ED. PHEAA is one of four Title IV Additional Servicers (TIVAS) that service student loans owned by ED. Additionally, ED has contracts with various not-for-profit entities to service student loans. 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. In December 2019, ED's Office of Federal Student Aid (FSA) amended the Agency's contract by extending the ending period of performance from December 15, 2019 to December 14, 2020. In addition, there are two options to extend the contract for an additional six months each, which would extend the contract period up to December 14, 2021.

ED continues to embark on a new transformation initiative known as the Next Generation Financial Services Environment (NextGen). Through this initiative, ED seeks to implement a flexible, efficient and effective financial solution to leverage in supporting its customers. On June 24, 2020, ED announced it had entered into contracts with five other companies through the Business Process Operations solicitation. On July 10, 2020, ED announced they were cancelling the existing Enhanced Processing Solution solicitation and they would be introducing a new solicitation in the coming months. On September 4, 2020, ED announced a pre-solicitation conference for the Interim Servicing Solution as a follow on to the existing TIVAS and not-for-profit servicing contracts. PHEAA continues to participate in the proposal process for components of the NextGen solution as they arise, however, the Agency cannot predict the ultimate timing, nature, or outcome of this process.

On March 27, 2020, the CARES Act was signed into law as a response to the COVID-19 pandemic. Under the CARES Act, loan payments and interest accruals were suspended on loans owned by ED effective March 13, 2020 through September 30, 2020. On August 8, 2020, the Secretary of Education was directed by the President of the United States through an Executive Order to extend these waivers through December 31, 2020. On August 21, 2020, the Secretary of Education directed FSA to extend the CARES Act benefits through December 31, 2020.

***Remote Servicing***

The remote servicing line of business provides the Agency's COMPASS system to guarantors, not-for-profit servicers 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. PHEAA has the authority to purchase FFEL program and alternative student loans from banks and other lenders. In addition, the Agency is able to purchase, hold and finance loans that are rehabilitated through the Agency's guaranty activities.

In August 2018, PHEAA's Executive Committee of the Board 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 in April 2019. In December 2019, the Agency launched the refinance loan portion of the PA Forward Private Student Loan Program.

Guaranty Activities

The FFEL 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 PHEAA. PHEAA also manages the Federal Student Loan Reserve Fund (Federal Fund) for ED.

The Agency has 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 the portfolio of guaranteed loans for that fiscal year and the disbursement date of the loan. In addition, PHEAA has agreements with ED in which ED will reimburse 100% of the amounts expended by the Agency resulting from the bankruptcy, death or disability of the borrower. The reinsurance rates, based on loan disbursement dates, are as follows:

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

The Agency has 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 the Agency 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, the Agency purchases and sells 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

The Agency follows the accounting and financial reporting guidance issued by the Governmental Accounting Standards Board (GASB). The financial statements are prepared using the economic resources measurement focus and accrual basis of accounting.

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

The Statements of Net Position report assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position. Assets are resources with present service capacity that PHEAA presently controls. 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 PHEAA has 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 measure the financial position at a point in time.

The Statements of Cash Flows supplement these statements by providing relevant information about cash receipts and disbursements 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 PHEAA's finances.

## Condensed Financial Information

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

| For the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Operating revenues: | | | |
| Student loan interest revenue, net | **$ 121,872** | $ 171,194 | $ 157,952 |
| Investment interest revenue | **17,547** | 25,117 | 16,051 |
| Total interest revenue | **139,419** | 196,311 | 174,003 |
| Interest expense on student loan financings, net | **(73,440)** | (104,571) | (72,951) |
| Interest expense on other financings, net | **120** | (204) | (348) |
| Total interest expense | **(73,320)** | (104,775) | (73,299) |
| Net interest revenue | **66,099** | 91,536 | 100,704 |
| Provision for loan losses | **(1,883)** | (3,435) | (3,538) |
| Net interest revenue after provision for loan losses | **64,216** | 88,101 | 97,166 |
| Total noninterest revenue | **449,029** | 448,339 | 484,620 |
| Total operating revenues | **513,245** | 536,440 | 581,786 |
| Total operating expenses | **(457,225)** | (494,926) | (560,308) |
| Operating income | **56,020** | 41,514 | 21,478 |
| Total grants and financial aid, net | **(4,239)** | (87,582) | (104,326) |
| Changes in net position | **51,781** | (46,068) | (82,848) |
| Net position, beginning of year | **174,444** | 220,512 | 304,364 |
| Net position, end of year | **$ 226,225** | $ 174,444 | $ 221,516 |

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 and premiums on student loan financings.

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

Statements of Net Position

(Dollars in thousands)

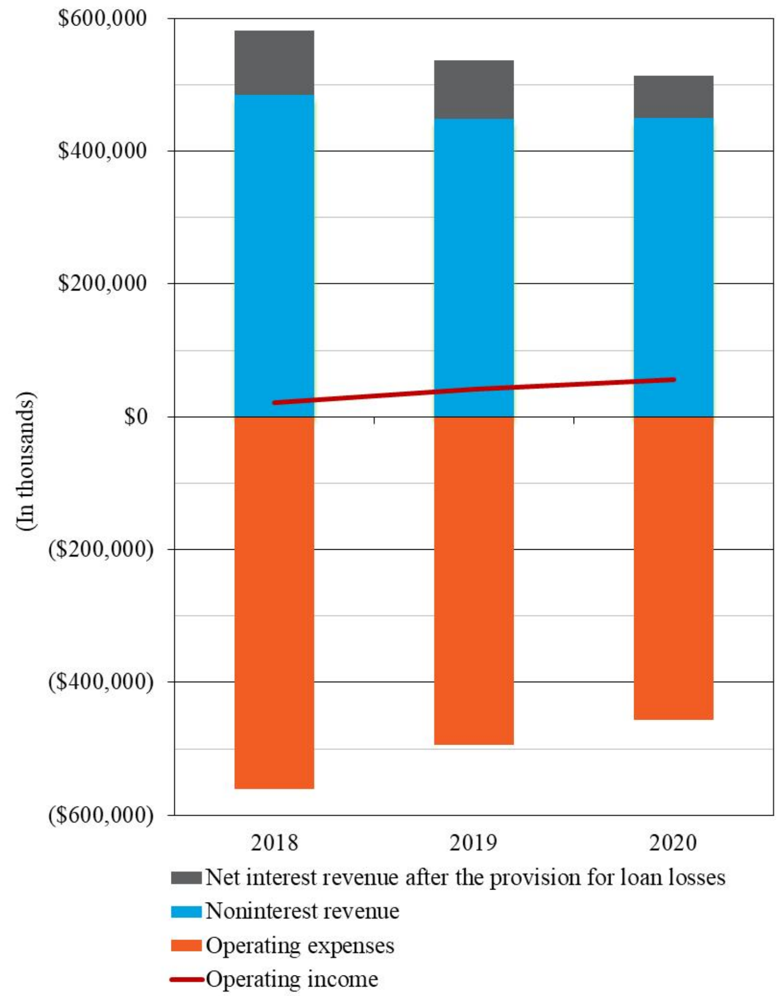
| As of June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Assets: | | | |
| Current assets: | | | |
| Cash, cash equivalents and investments (restricted and unrestricted) | **$ 645,913** | $ 681,824 | $ 749,675 |
| Student loans receivable | **486,186** | 572,934 | 752,702 |
| Other assets | **246,545** | 252,835 | 237,487 |
| Total current assets | **1,378,644** | 1,507,593 | 1,739,864 |
| Long-term assets: | | | |
| Student loans receivable, net | **2,936,817** | 3,318,921 | 3,822,546 |
| Capital assets, net | **129,835** | 103,356 | 91,025 |
| Total long-term assets | **3,066,652** | 3,422,277 | 3,913,571 |
| Total assets | **4,445,296** | 4,929,870 | 5,653,435 |
| Total deferred outflows of resources | **91,979** | 104,033 | 83,324 |
| Liabilities: | | | |
| Current liabilities: | | | |
| Student loan financings | **84,112** | 40,000 | 240,000 |
| Other liabilities | **191,893** | 249,022 | 227,876 |
| Total current liabilities | **276,005** | 289,022 | 467,876 |
| Long-term liabilities: | | | |
| Student loan financings, net | **3,159,513** | 3,650,100 | 4,108,779 |
| Net pension liability | **352,470** | 438,740 | 413,878 |
| Net other postemployment benefit liability | **218,891** | 274,286 | 357,062 |
| Other liabilities | **21,503** | 19,507 | 44,632 |
| Total long-term liabilities | **3,752,377** | 4,382,633 | 4,924,351 |
| Total liabilities | **4,028,382** | 4,671,655 | 5,392,227 |
| Total deferred inflows of resources | **282,668** | 187,804 | 123,016 |
| Net position: | | | |
| Net investment in capital assets | **129,835** | 103,356 | 91,025 |
| Restricted for debt service | **368,031** | 361,176 | 341,848 |
| Restricted for financial aid grant programs | **42,418** | 29,961 | 33,035 |
| Unrestricted | **(314,059)** | (320,049) | (244,392) |
| Total net position | **$ 226,225** | $ 174,444 | $ 221,516 |

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 and the premiums on education loan revenue bonds.

## Results of Operations

The following chart depicts the results of operations for the years ended June 30, 2020, 2019 and 2018.




The following tables display a summary of the results of operations.

| (Dollars in thousands)<br>For the years ended June 30, | | **2020** | | 2019 | | Change from 2019 to 2020 | Percentage change |
|---|---|---|---|---|---|---|---|
| Net interest revenue after provision for loan losses | **$** | **64,216** | $ | 88,101 | $ | (23,885) | -27% |
| Total noninterest revenue | | **449,029** | | 448,339 | | 690 | 0% |
| Total operating revenues | | **513,245** | | 536,440 | | (23,195) | -4% |
| Total operating expenses | | **(457,225)** | | (494,926) | | 37,701 | -8% |
| Operating income | **$** | **56,020** | $ | 41,514 | $ | 14,506 | 35% |

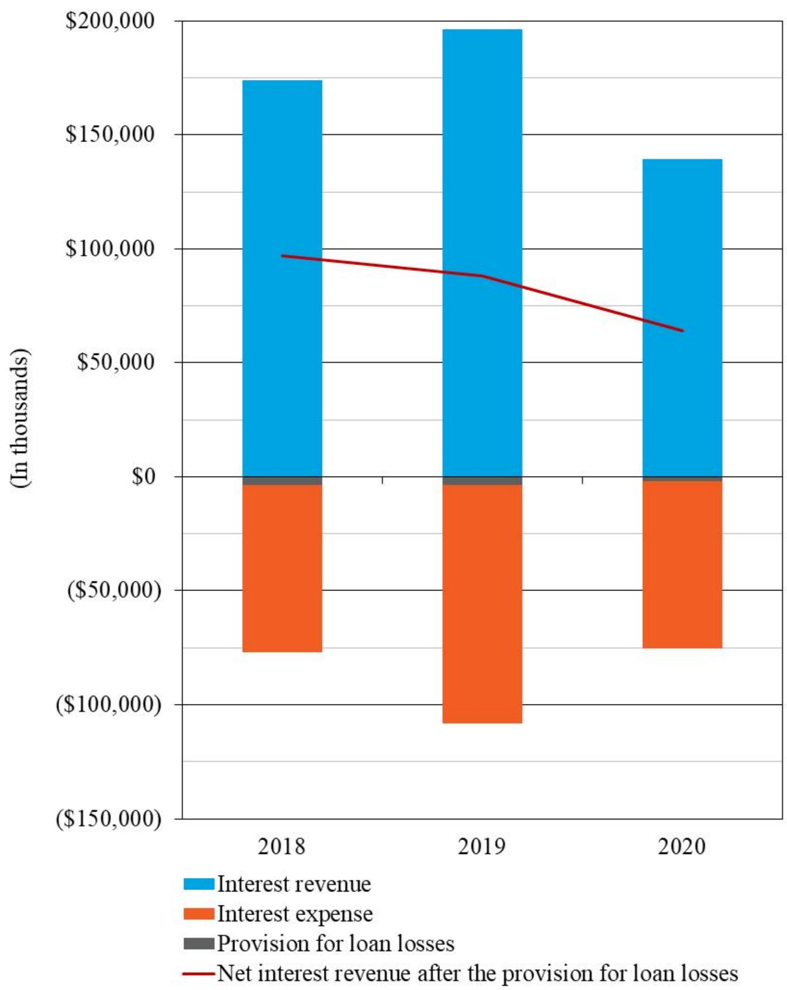
| (Dollars in thousands)<br>For the years ended June 30, | | 2019 | | 2018 | | Change from 2018 to 2019 | Percentage change |
|---|---|---|---|---|---|---|---|
| Net interest revenue after provision for loan losses | $ | **88,101** | $ | 97,166 | $ | (9,065) | -9% |
| Total noninterest revenue | | **448,339** | | 484,620 | | (36,281) | -7% |
| Total operating revenues | | **536,440** | | 581,786 | | (45,346) | -8% |
| Total operating expenses | | **(494,926)** | | (560,308) | | 65,382 | -12% |
| Operating income | $ | **41,514** | $ | 21,478 | $ | 20,036 | 93% |

A more detailed explanation of the results of operations follows.

Net Interest Revenue after Provision for Loan Losses

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

The following chart depicts the net interest revenue after provision for loan losses for the years ended June 30, 2020, 2019 and 2018.



For the year ended June 30, 2020, net interest revenue after provision for loan losses was $64.2 million, a 27% decrease from $88.1 million in 2019. For the year ended June 30, 2019, net interest revenue after provision for loan losses was $88.1 million, a 9% decrease from $97.2 million in 2018. The changes were due to decreases in interest rates and volume as discussed in the sections that follow.

***Net Interest Spread and Margin***

The following table presents an analysis of the net interest spread and margin. Net interest spread is the difference between the interest earned on the Agency's revenue generating rate related assets and the interest paid on the Agency's 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, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Interest yield: | | | |
| Student loan yield | **3.33%** | 4.05% | 3.31% |
| Investment yield | **2.52%** | 3.29% | 1.77% |
| Total interest yield | **3.20%** | 3.94% | 3.07% |
| Interest rate: | | | |
| Student loan financings rate | **(2.13%)** | (2.58%) | (1.56%) |
| Other financing rate | **0.65%** | (0.88%) | (1.26%) |
| Total interest rate | **(2.12%)** | (2.57%) | (1.56%) |
| Net interest spread | **1.08%** | 1.37% | 1.51% |
| Net interest margin | **1.52%** | 1.84% | 1.77% |
| Average balances (in thousands): | | | |
| Student loans | **$ 3,657,587** | $ 4,223,512 | $ 4,771,800 |
| Investments | **696,337** | 764,460 | 904,333 |
| Student loan financings | **3,447,400** | 4,055,912 | 4,673,548 |
| Other financings | **18,443** | 23,119 | 27,713 |

***Rate and Volume Analysis***

The amounts earned 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, 2020, 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) | **2020 vs. 2019** | | | 2019 vs. 2018 | | |
|---|---|---|---|---|---|---|
| | **Total increase** | **Increase (decrease) attributable to change in** | | Total increase | Increase (decrease) attributable to change in | |
| For the years ended June 30, | **(decrease)** | **Rate** | **Volume** | (decrease) | Rate | Volume |
| Student loan interest revenue, net | **$ (49,322)** | **$ (26,383)** | **$ (22,939)** | $ 13,242 | $ 31,391 | $ (18,149) |
| Investment interest revenue: | | | | | | |
| Investment income | **(4,908)** | **(3,277)** | **(1,631)** | 4,830 | 6,914 | (2,084) |
| Fair value adjustments | **(2,662)** | **(2,055)** | **(607)** | 4,236 | 4,634 | (398) |
| Total interest revenue | **(56,892)** | **(31,715)** | **(25,177)** | 22,308 | 42,939 | (20,631) |
| Student loan financings interest expense, net | **(31,131)** | **(15,442)** | **(15,689)** | 31,620 | 41,261 | (9,641) |
| Other financings interest expense, net | **(324)** | **(283)** | **(41)** | (144) | (86) | (58) |
| Total interest expense | **(31,455)** | **(15,725)** | **(15,730)** | 31,476 | 41,175 | (9,699) |
| Net interest revenue | **$ (25,437)** | **$ (15,990)** | **$ (9,447)** | $ (9,168) | $ 1,764 | $ (10,932) |

*2020 vs. 2019 – Changes in Rate and Volume*

For the year ended June 30, 2020, the decrease in the rate of the student loan interest revenue, net, was due to a decrease in the student loan interest yield because of the benchmark 1-month LIBOR decreasing by 93% year over year. The decrease in the volume of 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, 2020, the decrease in rate on investment income was due to a decrease in the dividend rate earned on Agency investments in the Commonwealth's Treasury Investment Pool. The decrease in rate of the fair value adjustment income is due to a decrease in the Net Asset Value (NAV) on the Agency investments in the Commonwealth's Treasury Investment Pool.

For the year ended June 30, 2020, the decrease in the rate of the student loan financings interest expense, net, was due to a decrease in the 1-month LIBOR and 3-month LIBOR, which was offset by a decrease in the amortization of the deferred gain on bond refundings. The decrease in volume of the student loan interest expense, net, was due to principal payments made on the student loan financing debt.

*2019 vs. 2018 – Changes in Rate and Volume*

For the year ended June 30, 2019, the increase in the rate of the student loan interest revenue, net, was due to an increase in student loan yield because of the benchmark 1-month LIBOR increasing by 15% year over year. The decrease in the volume of 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 the investment income was due to an increase in the dividend rate earned on Agency 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 NAV on Agency investments in the Commonwealth's Treasury Investment Pool.

For the year ended June 30, 2019, the increase in the rate of the 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 the student loan interest expense, net, was due to principal payments made on the 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, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Provision for loan losses | **$ 1,883** | $ 3,435 | $ 3,538 |

For the year ended June 30, 2020, the provision for loan losses was $1.9 million, a 44% decrease from $3.4 million in 2019. This change was mainly due to a change in the methodology used to record the provision for loan losses, which was implemented as of July 1, 2019. The provision for loan losses is determined by using trend data.

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

Noninterest Revenue

The following table displays the categories of noninterest revenue.

(Dollars in thousands)

| For the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Servicing fees | **$ 298,536** | $ 297,477 | $ 317,560 |
| Retention of collections on defaulted loans, net | **135,304** | 137,327 | 146,146 |
| Federal fees | **12,884** | 14,027 | 15,619 |
| Other | **2,305** | (492) | 5,295 |
| Total noninterest revenue | **$ 449,029** | $ 448,339 | $ 484,620 |

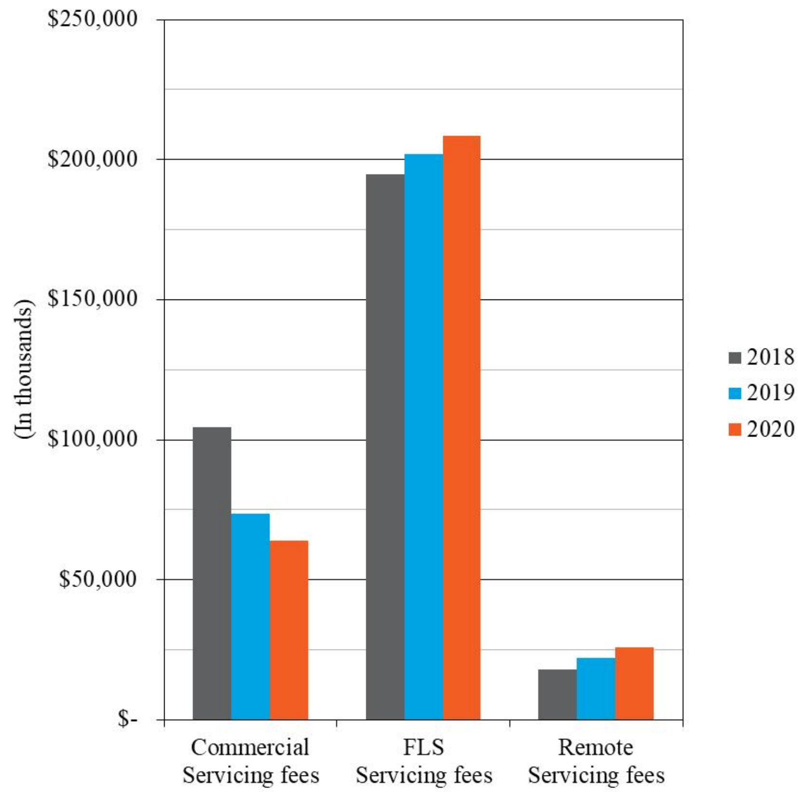
For the year ended June 30, 2020, total noninterest revenue was $449.0 million, a 0.2% increase from $448.3 million in 2019. For the year ended June 30, 2019, total noninterest revenue was $448.3 million, a 7% decrease from $484.6 million in 2018.

A more detailed discussion on the changes in total noninterest revenue is provided in the sections that follow.

***Servicing Fees***

PHEAA earns servicing fee revenue by servicing student loans owned by third parties. Revenue earned from servicing loans owned by ED are categorized as "FLS Servicing"; whereas revenue earned from servicing loans owned by financial institutions and secondary markets are categorized as "Commercial Servicing". Revenue earned from the "Remote Servicing" line of business is generated by providing the Agency's COMPASS system to guarantors and other servicers to use, as well as to not-for-profit servicers who were awarded servicing contracts by ED.

For the years ended June 30, 2020 and 2019, the Commercial Servicing loan portfolio continued to run-off as the FLS Servicing and Remote Servicing loan portfolios increased as seen in the following chart which depicts the servicing fee revenue for the years ended June 30, 2020, 2019 and 2018.




For the year ended June 30, 2020, total servicing fees were $298.5 million, a 0.3% increase from $297.5 million in 2019. The average balance of third party loans serviced on the Agency's systems increased to $466.8 billion in 2020 from $438.0 billion in 2019.

For the year ended June 30, 2019, total servicing fees were $297.5 million, a 6% decrease from $317.6 million in 2018. The average balance of third party loans serviced on the Agency's systems increased to $438.0 billion in 2019 from $406.5 billion in 2018.

***Retention of Collections on Defaulted Loans, net***

As a guarantor, PHEAA facilitates the guarantee of 97% to 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, PHEAA purchases rehabilitated student loans and sells them to eligible lenders, sometimes at a discount.

For the year ended June 30, 2020, the retention of collections on defaulted loans, net, was $135.3 million, a 1% decrease from $137.3 million in 2019. This decrease was mainly due to a decrease in administrative wage garnishment collection volume due to implementing the provisions of the CARES Act in the last quarter of the fiscal year, which was passed because of the COVID-19 pandemic. This was offset by an increase in total volume of collections on direct consolidation student loans.

For the year ended June 30, 2019, the retention of collections on defaulted loans, net, was $137.3 million, a 6% decrease from $146.1 million in 2018. This decrease was mainly due to reductions in the total volume of collections on rehabilitated student loans as less borrowers defaulted due to income based repayment options and a decrease in eligible loans to the rehabilitated.

Operating Expenses

The following table displays the major categories of operating expenses.

(Dollars in thousands)

| For the years ended June 30, | **2020** | | 2019 | | 2018 | |
|---|---|---|---|---|---|---|
| Personnel and benefits | **$ 220,993** | **48.3%** | $ 255,557 | 51.7% | $ 321,491 | 57.4% |
| Professional services | **104,322** | **22.8%** | 100,536 | 20.3% | 96,084 | 17.1% |
| Information technology related expenses | **69,729** | **15.3%** | 62,574 | 12.6% | 62,985 | 11.2% |
| Depreciation | **20,925** | **4.6%** | 20,914 | 4.2% | 20,045 | 3.6% |
| Mail services | **16,201** | **3.5%** | 21,130 | 4.3% | 24,380 | 4.4% |
| Other | **25,055** | **5.5%** | 34,215 | 6.9% | 35,323 | 6.3% |
| Total operating expenses | **$ 457,225** | **100.0%** | $ 494,926 | 100.0% | $ 560,308 | 100.0% |

For the year ended June 30, 2020, operating expenses were $457.2 million, an 8% decrease from $494.9 million in 2019. For the year ended June 30, 2019, operating expenses were $494.9 million, a 12% decrease from $560.3 million in 2018. The changes in personnel and benefits, information technology related expenses and other expenses are discussed in the sections that follow.

***Personnel and Benefits***

The following table provides a breakout of personnel and benefits expenses:

(Dollars in thousands)

| For the years ended June 30, | **2020** | | 2019 | | 2018 | |
|---|---|---|---|---|---|---|
| Compensation | **$ 144,159** | **65.2%** | $ 139,219 | 54.5% | $ 165,658 | 51.5% |
| Pension expense | **43,350** | **19.6%** | 62,699 | 24.5% | 66,039 | 20.5% |
| Health care benefits for employees | **28,805** | **13.0%** | 32,098 | 12.6% | 35,128 | 10.9% |
| Independent contractor fees | **18,496** | **8.4%** | 17,286 | 6.7% | 24,374 | 7.6% |
| Employer's share of Social Security and Medicare | **10,511** | **4.8%** | 10,999 | 4.3% | 12,271 | 3.8% |
| Capitalized software development costs | **(5,785)** | **(2.6%)** | (4,080) | (1.6%) | (4,194) | (1.3%) |
| Other postemployment benefits expense | **(20,424)** | **(9.2%)** | (4,107) | (1.6%) | 20,693 | 6.3% |
| Other | **1,881** | **0.8%** | 1,443 | 0.6% | 1,522 | 0.5% |
| Total personnel and benefits | **$ 220,993** | **100.0%** | $ 255,557 | 100.0% | $ 321,491 | 99.8% |

For the year ended June 30, 2020, personnel and benefits costs were $221.0 million, a 14% decrease from $255.6 million in 2019. For the year ended June 30, 2019, personnel and benefits costs were $255.6 million, a 20% decrease from $321.5 million in 2018. The changes in compensation, pension expense and other postemployment benefits expense are discussed in the sections that follow.

*Compensation*

For the year ended June 30, 2020, compensation expense was $144.2 million, a 4% increase from $139.2 million for 2019. The increase was mainly due to an increase in the annual and sick leave expenses partially offset by reductions in personnel. For the year ended June 30, 2019, compensation expense was $139.2 million, a 16% decrease from $165.7 million for 2018. The decrease was mainly due to reductions in personnel, sick and leave accruals and overtime.

*Pension Expense*

For the year ended June 30, 2020, pension expense was $43.4 million, a 31% decrease from $62.7 million for 2019. For the year ended June 30, 2019, pension expense was $62.7 million, a 5% decrease from $66.0 million for 2018. The decreases were mainly due to changes in the total pension liability of the Commonwealth's pension plan resulting from strong investment returns and the reduction in the Agency's covered payroll. The reductions in covered payroll directly affected the Agency's proportionate share of the collective pension expense.

*Other Postemployment Benefits (OPEB) Expense*

For the year ended June 30, 2020, OPEB expense was a negative $20.4 million, a 398% change from a negative $4.1 million in 2019. For the year ended June 30, 2019, OPEB expense was a negative $4.1 million, a 120% change from $20.7 million in 2018. Based on the most recent valuation received from the Commonwealth, the Commonwealth's Retired Employees Health Plan (REHP) experienced lower claims costs, which resulted from rebidding the medical and prescription drug plans.

***Information Technology Related Expenses***

For the year ended June 30, 2020, information technology related expenses were $69.7 million, an 11% increase from $62.6 million in 2019. For the year ended June 30, 2019, information technology related expenses were $62.6 million, a 1% decrease from $63.0 million in 2018. These increases were due to changes in managed service contracts related to mainframe and software expenses. In addition, purchases of equipment were expedited due to a shift in personnel working remotely during the COVID-19 pandemic.

***Other Expenses***

For the year ended June 30, 2020, other expenses were $25.1 million, a 27% decrease from $34.2 million in 2019. This decrease was mainly due to the reductions in telephone expenses and mailings costs. The reductions in telephone expenses and mailing costs are partially due to the implementation of strategic projects to reduce costs in both of these areas, as well as the effect of the COVID-19 pandemic. The CARES Act, which was passed in response to the COVID-19 pandemic, paused borrower payments starting in March 2020. As a result, there were fewer contact calls and mailings.

<u>Grants and Financial Aid, net</u>

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

(Dollars in thousands)

| For the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Commonwealth of Pennsylvania grants | **$ 380,229** | $ 333,212 | $ 333,560 |
| Federal grants | **3,818** | 1,620 | 1,598 |
| Grants and other financial aid, net of refunds | **(388,286)** | (422,414) | (439,484) |
| Total grants and financial aid, net | **$ (4,239)** | $ (87,582) | $ (104,326) |

***Commonwealth of Pennsylvania Grants***

For the year ended June 30, 2020, the Commonwealth of Pennsylvania grants were $380.2 million, a 14% increase from $333.2 million in 2019. For the year ended June 30, 2020, the Commonwealth appropriations total $369.4 million, a 15%

increase over $322.6 million for the year ended June 30, 2019. Appropriations from the Commonwealth were consistent for the years ended June 30, 2019 and 2018. The remaining grant funding from the Commonwealth represents pass-through grants that vary year to year.

***Grants and Other Financial Aid, net***

The following table provides a breakout of grants and other financial aid, net of refunds:

(Dollars in thousands)

| For the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Grants and other financial aid, net of refunds: | | | |
| Pennsylvania State Grant Program, net of refunds | **$ 319,940** | $ 350,392 | $ 357,606 |
| Institutional Assistance Grant Program, net of refunds | **26,676** | 26,478 | 25,742 |
| Matching Payments for Student Aid Program, net of refunds | **12,014** | 12,483 | 12,504 |
| Pennsylvania National Guard Education Assistance Program, net of refunds | **10,871** | 10,236 | 11,278 |
| Pennsylvania Ready to Succeed Scholarship Program, net of refunds | **5,498** | 5,121 | 4,963 |
| Pennsylvania Targeted Industry Program, net of refunds | **5,332** | 5,181 | 6,141 |
| Higher Education for the Disadvantaged, net of refunds | **2,313** | 2,270 | 2,236 |
| Pennsylvania Distance Education Program, net of refunds | **(74)** | 1,204 | 10,339 |
| Primary Healthcare Loan Forgiveness, net of refunds | **(488)** | 4,259 | 4,492 |
| Other programs, net of refunds | **6,204** | 4,790 | 4,183 |
| Total grants and other financial aid, net | **$ 388,286** | $ 422,414 | $ 439,484 |

For the year ended June 30, 2020, grants and other financial aid, net of refunds, were $388.3 million, an 8% decrease from $422.4 million in 2019. For the year ended June 30, 2019, grants and other financial aid, net of refunds, were $422.4 million, a 4% decrease from $439.5 million in 2018. During the year ended June 30, 2020, there were less recipients of the Pennsylvania State Grant Program compared to the year ended June 30, 2019. Typically, as unemployment rates decline, the number of participants decreases. Unemployment rates had been steadily declining prior to the COVID-19 pandemic. In addition, the changes in the grant activity are partially dependent on the grant funding from the Commonwealth and PHEAA. During the year ended June 30, 2020, the Agency's funding decreased $55.0 million from 2019, which was mainly due to an increase of funding from the Commonwealth of $47.0 million.

## Student Loans Receivable, net

The following table summarizes the student loans receivable, net.

| As of June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Student loans receivable: | | | |
| Total FFEL student loans | **$ 3,369,098** | $ 3,873,625 | $ 4,558,737 |
| Total private and HEAL student loans | **59,969** | 25,610 | 28,451 |
| Total student loans receivable | **3,429,067** | 3,899,235 | 4,587,188 |
| Student loans purchased at year end and pending conversion | **242** | - | - |
| Unamortized student loan purchase premium | **656** | 1,778 | 3,431 |
| Unamortized student loan purchase discount | **(2,720)** | (4,332) | (9,240) |
| Allowance for loan losses | **(4,242)** | (4,826) | (6,131) |
| Total student loans receivable, net | **$ 3,423,003** | $ 3,891,855 | $ 4,575,248 |

As of June 30, 2020, student loans receivable, net was $3.4 billion, a 13% decrease from $3.9 billion as of June 30, 2019. As of June 30, 2019, student loans receivable, net was $3.9 billion, a 15% decrease from $4.6 billion as of June 30, 2018. The decrease in student loans receivable, net, was mainly due to borrower payments, claims and consolidation payoffs, which were partially offset by an increase in the loan portfolio of the Agency's PA Forward Private Student Loan Program.

Delinquencies have the potential to affect earnings adversely through increased collection costs and charge-offs/write-offs. The June 30, 2020 table below presents the student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $0.2 million of student loans categorized as non-performing, $2.5 million of student loans categorized as uninsured, $0.1 million of student loans with credit balances and $0.3 million of student loan payments in-process.

(Dollars in thousands)

| As of June 30, 2020 | FFEL | | Non-FFEL | | Total | |
|---|---|---|---|---|---|---|
| Loans in-school/in-grace | $ 1,224 | | $ 27,672 | | $ 28,896 | |
| Loans in deferment | 149,485 | | - | | 149,485 | |
| Loans in forbearance | 486,180 | | 28,195 | | 514,375 | |
| Total loans in-school/in-grace, deferment and forbearance | 636,889 | | 55,867 | | 692,756 | |
| Loans in repayment: | | | | | | |
| Current | 2,562,515 | 93.9% | 3,597 | 92.4% | 2,566,112 | 93.9% |
| 31 – 60 days | 48,613 | 1.8% | 35 | 0.9% | 48,648 | 1.8% |
| 61 – 90 days | 26,742 | 1.0% | 62 | 1.6% | 26,804 | 1.0% |
| 91 – 120 days | 14,242 | 0.5% | 1 | 0.0% | 14,243 | 0.5% |
| 121 – 180 days | 26,983 | 1.0% | 49 | 1.3% | 27,032 | 1.0% |
| 181 – 270 days | 30,548 | 1.1% | - | 0.0% | 30,548 | 1.1% |
| 271 days or greater | 13,657 | 0.5% | 47 | 1.2% | 13,704 | 0.5% |
| Claims filed not paid | 6,202 | 0.2% | 103 | 2.6% | 6,305 | 0.2% |
| Total loans in repayment | 2,729,502 | 100.0% | 3,894 | 100.0% | 2,733,396 | 100.0% |
| Total student loans | $ 3,366,391 | | $ 59,761 | | $ 3,426,152 | |

At June 30, 2020, the loans in forbearance were $514.4 million, which is an increase of 61% from $320.3 million at June 30, 2019. During the COVID-19 pandemic, some FFEL loan borrowers opted to enter into the national disaster forbearance pursuant to the Higher Education Act, which is provided for a maximum of 90 days. In addition, PHEAA provided a natural disaster forbearance status for certain PHEAA owned private student loans for the period of March 13, 2020 through September 30, 2020.

The June 30, 2019 table below presents the 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 | |
| Loans in forbearance | 320,132 | | 187 | | 320,319 | |
| Total loans in-school/in-grace, 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 | |

Allowance for Loan Losses

Allowances for potential losses on student loans receivable can result from the risk sharing on defaulted and uninsured loans. The allowance amounts are based upon an ongoing evaluation of the loan portfolios, past and anticipated loss experience and the amount and quality of the loans. The allowances are maintained at a level that management believes are adequate to absorb estimated incurred losses, but the evaluation is inherently subjective and the required allowances may significantly change in the future. As of June 30, 2020, management believes the allowance for loan losses is adequate to cover the inherent losses on the student loan portfolio.

Separate calculations of the allowance for loan losses are performed on 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 summarize the allowance for loan losses for the FFEL and non-FFEL student loan portfolios. For additional information, please refer to **Note 5 - Student Loans Receivable, net**, and the "Net Interest Revenue after the Provision for Loan Losses" discussion under the **"Results of Operations"** section within the MD&A.

***FFEL Program Loans***

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

(Dollars in thousands)

| As of and for the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Balance at beginning of year | **$ 4,609** | $ 5,776 | $ 6,295 |
| Provision for losses | **1,031** | 3,703 | 3,323 |
| Charge-offs/Write-offs | **(2,218)** | (4,870) | (3,842) |
| Balance at end of year | **$ 3,422** | $ 4,609 | $ 5,776 |
| Ending balance of student loans | **$ 3,369,098** | $ 3,873,625 | $ 4,558,737 |
| Allowance as a percentage of ending balance of student loans | **0.10%** | 0.12% | 0.13% |

***Other Program Loans (Non-FFEL)***

The allowance for loan losses - other program loans (Non-FFEL) represents the 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 and for the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Balance at beginning of year | **$ 217** | $ 355 | $ 351 |
| Provision for losses | **852** | (268) | 215 |
| Charge-offs/Write-offs | **(249)** | 130 | (211) |
| Balance at end of year | **$ 820** | $ 217 | $ 355 |
| Ending balance of student loans | **$ 59,969** | $ 25,610 | $ 28,451 |
| Allowance as a percentage of ending balance of student loans | **1.37%** | 0.85% | 1.25% |

During the year ended June 30, 2020, the Agency's PA Forward Private Student Loan Program completed its first year in operation; therefore, a provision for loan losses of $675 thousand was recorded.

## Capital Assets

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

(Dollars in thousands)

| As of June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Land | **$ 8,179** | $ 8,044 | $ 8,038 |
| Software, net (purchased and developed) | **81,597** | 53,315 | 38,110 |
| Buildings and improvements, net | **25,074** | 26,362 | 29,630 |
| Information technology equipment, net | **12,206** | 12,064 | 10,648 |
| Other, net | **2,779** | 3,571 | 4,599 |
| Total capital assets, net | **$ 129,835** | $ 103,356 | $ 91,025 |

As of June 30, 2020, capital assets, net of accumulated depreciation and amortization, were $129.8 million, a 26% increase from $103.4 million as of June 30, 2019. As of June 30, 2019, capital assets, net of accumulated depreciation and amortization, were $103.4 million, a 14% increase from $91.0 million as of June 30, 2018. These increases were mainly due to increases in software related to the Agency's information technology transformation projects, which was partially offset by the depreciation and amortization of capital assets.

## Debt Activity

The schedule that follows contains select debt activity from the Statements of Net Position.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Deferred outflows of resources: | | | |
| Deferred loss on bond refundings | **$ 1,282** | $ 1,967 | $ 2,345 |
| Current liabilities: | | | |
| Student loan financings | **84,112** | 40,000 | 240,000 |
| Other financings | **448** | - | 4,230 |
| Long-term liabilities: | | | |
| Student loan financings, net | **3,159,513** | 3,650,100 | 4,108,779 |
| Other financings, net | **8,015** | 6,965 | 21,377 |
| Deferred inflows of resources: | | | |
| Deferred gain on bond refundings | **869** | 14,472 | 42,007 |

PHEAA's 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, 2020, PHEAA's outstanding debt, excluding 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 outstanding debt of PHEAA's blended component units are excluded from this threshold, because their debt was not issued by PHEAA. As of June 30, 2020, the outstanding debt of the blended component units was $2.8 billion, which was related to the student loan trusts. See **Note 13 – Blended Component Units** for more details on the student loan trusts.

The following table shows the proceeds and repayment activity of the Agency's debt.

(Dollars in thousands)

| For the year ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Capital market activity: | | | |
| Proceeds from issuing education loan revenue bonds | **$ 47,570** | $ - | $ - |
| Proceeds from issuing student loan floating rate notes | **-** | 426,700 | - |
| Repayment of student loan floating rate notes | **(540,773)** | (640,331) | (741,341) |
| Repayment of student loan auction rate security bonds | **(1,400)** | (1,990) | (164,359) |
| Repayment of education loan revenue bonds | **(200)** | - | - |
| Student loan financing activity: | | | |
| Proceeds from student loan financings | **64,612** | - | 461,932 |
| Repayment of student loan financings | **(20,500)** | (445,986) | (175,946) |
| Other financing activity: | | | |
| Repayment of capital acquisition refunding bonds | **-** | (18,245) | (4,055) |

***Capital Market and Student Loan Financing Activity***

For the year ended June 30, 2020, the Agency issued $47.6 million of education loan revenue bonds mainly to support the Agency's PA Forward Private Student Loan Program. In addition, the Agency drew down $64.6 million from a line of credit in order to purchase rehabilitated loans and to help fund the PA Forward Private Student Loan Program.

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.

The repayments of capital market and student loan financing activity 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.

See **Note 7 – Notes and Bonds Payable and Other Financings** for more details on the debt activity.

## Net Position

The following table displays the restricted and unrestricted net position.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Net investment in capital assets | **$ 129,835** | $ 103,356 | $ 91,025 |
| Restricted for debt service | **368,031** | 361,176 | 341,848 |
| Restricted for financial aid grant programs | **42,418** | 29,961 | 33,035 |
| Unrestricted | **(314,059)** | (320,049) | (244,392) |
| Total net position | **$ 226,225** | $ 174,444 | $ 221,516 |

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

As of June 30, 2020, the net investment in capital assets was $129.8 million, a 26% increase from $103.4 million as of June 30, 2019. As of June 30, 2019, the net investment in capital assets was $103.4 million, a 14% increase from $91.0 million as of June 30, 2018. The increases in the net investment in capital assets were mainly due to increases in software related to the Agency's 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, 2020, net position restricted for debt service was $368.0 million, a 2% increase from $361.2 million as of June 30, 2019. The increase in net position restricted for debt service was due to $26.9 million of operating income restricted for debt service. In addition, $1.9 million of CARES Act grant funding was received during the year. These increases were partially offset by $22.0 million of transfers to unrestricted net position.

As of June 30, 2019, net position restricted for debt service was $361.2 million, a 6% 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.

See **Note 12 - Segment Information** for more details.

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

As of June 30, 2020, net position restricted for financial aid grant programs was $42.4 million, a 41% increase from $30.0 million as of June 30, 2019. As of June 30, 2019, net position restricted for financial aid grant programs was $30.0 million, a 9% decrease from $33.0 million as of June 30, 2018. 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, 2020, unrestricted net position was a negative $314.1 million, a 2% increase from a negative $320.0 million as of June 30, 2019. The increase in unrestricted net position was due to unrestricted operating income of $26.1 million and $22.0 million of funds transferred from net position restricted for debt service. These increases were offset by $26.4 million of funds transferred to the net investment in capital assets and $13.0 million of net transfers to net position restricted for financial aid grant programs. In addition, the beginning unrestricted net position decreased by $2.8 million due to the Pennsylvania Targeted Industry Program being transferred from unrestricted to restricted for financial aid grant programs as of July 1, 2019.

As of June 30, 2019, unrestricted net position of a negative $320.0 million, a 31% 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, $6.6 million of net grant disbursements and $12.4 million of funds transferred to the net investment in capital assets. These decreases were offset by $19.8 million of funds transferred from net position restricted for debt service. In addition, the unrestricted net position 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. For additional information, please refer to the "Statements of Revenues, Expenses and Changes in Net Position" discussion under the "**Condensed Financial Information**" section within the MD&A.

## Federal Student Loan Reserve Fund (Federal Fund)

The Federal Fund accounts for PHEAA's guaranty activity under the FFEL program. PHEAA pays claims on defaulted loans out of the Federal Fund. The assets of the Federal Fund and the earnings on those assets are, at all times, the property of the United States government. PHEAA 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 displays the changes in the Federal Fund.

(Dollars in thousands)

| For the years ended June 30, | **2020** | 2019 | 2018 |
|---|---|---|---|
| Additions: | | | |
| Reinsurance from the U.S. Department of Education | **$ 672,685** | $ 843,090 | $ 857,534 |
| Collections on defaulted loans | **637,520** | 653,035 | 734,884 |
| Net appreciation in the fair value of investments | **395** | 308 | 219 |
| Total additions | **1,310,600** | 1,496,433 | 1,592,637 |
| Deductions: | | | |
| Purchases of defaulted loans from lenders | **671,301** | 841,395 | 855,416 |
| Reimbursement to U.S. Department of Education for federal share of defaulted loans collections | **491,061** | 503,384 | 565,154 |
| Reimbursement to PHEAA for retention of defaulted loans collections | **139,245** | 139,162 | 154,555 |
| Default aversion fees, net | **1,680** | 1,249 | 4,908 |
| Other | **22** | 27 | - |
| Total deductions | **1,303,309** | 1,485,217 | 1,580,033 |
| Net increase | **7,291** | 11,216 | 12,604 |
| Net liabilities, beginning of year | **(121,458)** | (132,674) | (145,278) |
| Net liabilities, end of year | **$ (114,167)** | $ (121,458) | $ (132,674) |

For the year ended June 30, 2020, reinsurance from ED was $672.7 million, a 20% decrease from $843.1 million in 2019. For the year ended June 30, 2020, purchases of defaulted loans were $671.3 million, a 20% decrease from $841.4 million in

2019. In addition, reinsurance from ED and purchases of defaulted loans decreased 2% from 2018 to 2019. The decreases were due to a decrease in borrowers defaulting with third party FFEL lenders.

For the year ended June 30, 2020, collections on defaulted loans were $637.5 million, a 2% decrease from $653.0 million in 2019. For the year ended June 30, 2020, reimbursement to ED for the federal share of defaulted loans collections was $491.1 million, a 2% decrease from $503.4 million in 2019. In addition, collections on defaulted loans and reimbursement to ED for the federal share of defaulted loans collections decreased 11% from 2018 to 2019. The decreases were due to the decrease in the inventory of rehabilitated and direct consolidation loans.

See **Note 3 – Federal Student Loan Reserve Fund (Federal Fund) and Assets Held for the U.S. Department of Education** for more details.

Federal Reserve Ratio

Under the Higher Education Act of 1965, as amended, Section 428(c)(9)(A), PHEAA is 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 PHEAA files 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 the 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, 2020** | As of September 30, 2019 |
|---|---|---|
| Generally accepted accounting principles – net assets | **$ (114,167)** | $ (119,711) |
| 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 | **20,547** | 29,754 |
| Gain contingency – default aversion fee rebate payable from PHEAA to the Federal Fund | **9,593** | 9,537 |
| Regulatory net assets | **$ 106,933** | $ 110,540 |
| Original principal outstanding | **$ 18,133,777** | $ 19,897,104 |
| Federal reserve ratio | **0.59%** | 0.56% |
| Minimum federal reserve ratio | **0.25%** | 0.25% |

## Contacting the Agency

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

Phone – (717) 720-7890
Fax – (717) 720-3923

September 17, 2020

(Dollars in thousands)

| | 2020 | 2019 |
|---|---|---|
| Operating revenues: | | |
| Interest revenue: | | |
| Student loans, net | **$ 121,872** | $ 171,194 |
| Investments | **17,547** | 25,117 |
| Total interest revenue | **139,419** | 196,311 |
| Interest expense: | | |
| Student loan financings, net | **73,440** | 104,571 |
| Other financings, net | **(120)** | 204 |
| Total interest expense | **73,320** | 104,775 |
| Net interest revenue | **66,099** | 91,536 |
| Provision for loan losses | **(1,883)** | (3,435) |
| Net interest revenue after provision for loan losses | **64,216** | 88,101 |
| Noninterest revenue: | | |
| Servicing fees | **298,536** | 297,477 |
| Retention of collections on defaulted loans, net | **135,304** | 137,327 |
| Federal fees | **12,884** | 14,027 |
| Other | **2,305** | (492) |
| Total noninterest revenue | **449,029** | 448,339 |
| Total operating revenues | **513,245** | 536,440 |
| Operating expenses: | | |
| Personnel and benefits | **220,993** | 255,557 |
| Professional services | **104,322** | 100,536 |
| Information technology related expenses | **69,729** | 62,574 |
| Depreciation | **20,925** | 20,914 |
| Mail services | **16,201** | 21,130 |
| Other | **25,055** | 34,215 |
| Total operating expenses | **457,225** | 494,926 |
| Operating income | **56,020** | 41,514 |
| Grants and financial aid: | | |
| Commonwealth of Pennsylvania grants | **380,229** | 333,212 |
| Federal grants | **3,818** | 1,620 |
| Grants and other financial aid, net of refunds | **(388,286)** | (422,414) |
| Total grants and financial aid, net | **(4,239)** | (87,582) |
| Changes in net position | **51,781** | (46,068) |
| Net position, beginning of year | **174,444** | 220,512 |
| Net position, end of year | **$ 226,225** | $ 174,444 |

See accompanying notes to the financial statements.

(Dollars in thousands)

| | | 2020 | | 2019 |
|---|---|---|---|---|
| Assets: | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 113,328 | $ | 103,576 |
| Restricted cash and cash equivalents | | 152,257 | | 153,097 |
| Restricted cash and cash equivalents – due to customers | | 30,039 | | 61,978 |
| Investments | | 308,406 | | 334,483 |
| Restricted investments | | 41,883 | | 28,690 |
| Student loans receivable | | 486,186 | | 572,934 |
| Interest income receivable | | 89,009 | | 94,530 |
| Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net | | 86,398 | | 82,009 |
| Due from Federal Student Loan Reserve Fund, net | | 9,606 | | 12,508 |
| Other assets | | 61,532 | | 63,788 |
| Total current assets | | 1,378,644 | | 1,507,593 |
| Long-term assets: | | | | |
| Student loans receivable, net | | 2,936,817 | | 3,318,921 |
| Capital assets, net | | 129,835 | | 103,356 |
| Total long-term assets | | 3,066,652 | | 3,422,277 |
| Total assets | | 4,445,296 | | 4,929,870 |
| Deferred outflows of resources: | | | | |
| Deferred outflows of resources related to pensions | | 45,583 | | 98,343 |
| Deferred outflows of resources related to other postemployment benefits | | 45,114 | | 3,723 |
| Deferred loss on bond refundings | | 1,282 | | 1,967 |
| Total deferred outflows of resources | | 91,979 | | 104,033 |
| Liabilities: | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued expenses | | 105,047 | | 167,013 |
| Student loan financings | | 84,112 | | 40,000 |
| Amounts related to the Federal Student Loan Reserve Fund | | 86,398 | | 82,009 |
| Other financings | | 448 | | - |
| Total current liabilities | | 276,005 | | 289,022 |
| Long-term liabilities: | | | | |
| Student loan financings, net | | 3,159,513 | | 3,650,100 |
| Net pension liability | | 352,470 | | 438,740 |
| Net other postemployment benefit liability | | 218,891 | | 274,286 |
| Other financings, net | | 8,015 | | 6,965 |
| Accrued expenses | | 13,488 | | 12,542 |
| Total long-term liabilities | | 3,752,377 | | 4,382,633 |
| Total liabilities | | 4,028,382 | | 4,671,655 |
| Deferred inflows of resources: | | | | |
| Deferred gain on bond refundings | | 869 | | 14,472 |
| Deferred inflows of resources related to pensions | | 87,961 | | 52,362 |
| Deferred inflows of resources related to other postemployment benefits | | 193,838 | | 120,906 |
| Deferred gain on sales leaseback | | - | | 64 |
| Total deferred inflows of resources | | 282,668 | | 187,804 |
| Net position: | | | | |
| Net investment in capital assets | | 129,835 | | 103,356 |
| Restricted for debt service | | 368,031 | | 361,176 |
| Restricted for financial aid grant programs | | 42,418 | | 29,961 |
| Unrestricted | | (314,059) | | (320,049) |
| Total net position | $ | 226,225 | $ | 174,444 |

See accompanying notes to the financial statements.

(Dollars in thousands)

| | 2020 | 2019 |
|---|---|---|
| Cash flows from operating activities: | | |
| Interest received on student loans | $ 90,514 | $ 118,145 |
| Principal received on student loans | 586,858 | 674,018 |
| Student loan originations | (43,188) | (52) |
| Student loan purchases | (462,707) | (468,516) |
| Student loan sales, including net gains and losses | 424,158 | 527,272 |
| Servicing fees | 300,016 | 297,793 |
| Retention of collections on defaulted loans | 138,174 | 136,037 |
| Federal fees | 12,946 | 14,447 |
| Default aversion fee rebates | 1,046 | 68 |
| Other | (100) | (1,615) |
| Payment of operating expenses | (477,979) | (436,865) |
| Net cash provided by operating activities | 569,738 | 860,732 |
| Cash flows from noncapital financing activities: | | |
| Proceeds from issuance of noncapital debt | 112,182 | 426,700 |
| Original issue premium on noncapital debt | 2,426 | - |
| Principal paid on noncapital debt | (562,873) | (1,106,552) |
| Interest paid on noncapital debt | (87,356) | (130,695) |
| Bond issuance costs | (4,331) | (6,097) |
| Commonwealth of Pennsylvania grants received | 380,229 | 333,212 |
| Federal grants received | 3,818 | 1,620 |
| Grants and financial aid paid | (388,286) | (422,414) |
| Net cash used in noncapital financing activities | (544,191) | (904,226) |
| Cash flows from capital and related financing activities: | | |
| Purchases of capital assets and development of software, net of disposals | (47,468) | (33,342) |
| Net cash used in capital and related financing activities | (47,468) | (33,342) |
| Cash flows from investing activities: | | |
| Proceeds from sales and maturities of investments | 744,948 | 750,803 |
| Purchases of investments | (727,914) | (650,700) |
| Interest received on investments | 13,799 | 18,209 |
| Net cash provided by investing activities | 30,833 | 118,312 |
| Net change in cash and cash equivalents (including restricted cash) | 8,912 | 41,476 |
| Cash and cash equivalents (including restricted cash), beginning of year | 256,673 | 215,197 |
| Cash and cash equivalents (including restricted cash), end of year | $ 265,585 | $ 256,673 |

(continued)

(Dollars in thousands)

| | 2020 | 2019 |
|---|---|---|
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | **$ 56,020** | $ 41,514 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | **20,925** | 20,914 |
| Interest paid on noncapital debt | **87,356** | 130,694 |
| Investment interest | **(17,547)** | (25,117) |
| Bond issuance costs | **4,331** | 6,097 |
| Pension expense valuation adjustment | **2,089** | 20,244 |
| Other postemployment benefit expense valuation adjustment | **(23,855)** | (7,830) |
| Amortization of premium on loan purchases | **1,123** | 1,653 |
| Amortization of gain and loss on bond refunding | **(12,918)** | (26,867) |
| Amortization of discount on bonds payable | **1,876** | 2,638 |
| Amortization of premium on bonds payable | **(86)** | - |
| Amortization of premium on other financings | **(294)** | (397) |
| Changes in assets and liabilities: | | |
| Decrease in interest income receivable | **5,118** | 150 |
| Decrease in student loans receivable | **467,729** | 681,740 |
| Decrease (increase) in amounts due from Federal Student Loan Reserve Fund | **2,902** | (1,221) |
| Decrease (increase) in other assets | **2,256** | (1,712) |
| (Decrease) increase in accounts payable and accrued expenses | **(27,287)** | 18,232 |
| Total adjustments | **513,718** | 819,218 |
| Net cash provided by operating activities | **$ 569,738** | $ 860,732 |

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. PHEAA's mission is to create affordable access to higher education.

The Commonwealth of Pennsylvania (Commonwealth or Pennsylvania) presents PHEAA's financial information as a discretely presented component unit within their Comprehensive Annual Financial Report. Component units are legally separate organizations for which the elected officials of the Commonwealth are financially accountable. In addition, 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. The Commonwealth appoints all twenty voting members of PHEAA's Board of Directors, a significant financial burden exists on the Commonwealth to subsidize the Pennsylvania State Grant Program and the Governor of Pennsylvania (Governor) must approve the Agency's debt issuances. Although the Commonwealth is not obligated for the Agency's debt, the Commonwealth has indicated it could take certain actions to satisfy debt holders.

Blended Component Units

***PHEAA Student Loan Foundation, Inc.***

The Agency 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 PHEAA's benefit. PHEAA appoints a majority of the Foundation's board of directors and it can impose its will on the Foundation. In addition, the Foundation provides services entirely to PHEAA. As a result, PHEAA reports the Foundation as a blended component unit. The financial results of the Foundation are consolidated with the financial results of PHEAA.

***PHEAA Student Loan Trusts***

The Agency has various student loan trusts that are statutory trusts formed under the laws of the State of Delaware and they are legally separate entities. The principal purpose of the student loan trusts is to securitize student loans and related assets and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the 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.

The PHEAA Student Loan Trusts are considered a blended component unit of the Foundation because of the material relationship with the Foundation and they provide services entirely to the Foundation. Since the Foundation is a blended component unit of the Agency, the financial results of the PHEAA Student Loan Trusts are also consolidated with the financial results of PHEAA. See **Note 13 - Blended Component Units**.

## Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Accounting

The basic financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in conformity with generally accepted accounting principles (GAAP) in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB). The proprietary fund financial statements focus on the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows.

Elimination of Intra-Entity Activity

The Agency is the administrator and servicer for its blended component units. The resource flows between the Agency and the blended component units are considered intra-entity activity. As a result, the intra-entity activity is eliminated in the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position, and the Statements of Cash Flows.

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that influence the reported amounts and disclosures. Actual results could differ significantly from those estimates.

Cash Equivalents

Cash equivalents are reported at fair value. Cash equivalents are short-term, liquid investments that are readily convertible to known amounts of cash and are 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.

Restricted Cash and Investments

Restricted cash and investments include cash received from the Commonwealth for allocated grant funding. In addition, bond proceeds held by a trustee and restricted by the provision of bond indentures and financing agreements are included in restricted cash and investments. These amounts are restricted because they cannot be disbursed for any other purpose.

Investments

Investments are reported at fair value. Investments include amounts in the Commonwealth's Treasury Department Bureau of Cash Management and Investments (Treasury Department) State Treasury Investment Pool, 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 information on the net asset value for Pools 998 and 999.

Student Loans Receivable, net

The student loans receivable represents the outstanding student loans at their unpaid principal balances net of an allowance for inherent losses within the student loan portfolio and unamortized premiums and discounts related to student loan purchases.

***Allowance for Loan Losses***

The Agency estimates an allowance for loan losses based upon an ongoing evaluation of the student loan portfolios, past and anticipated loss experience and the amount and quality of the student loans. The Agency maintains the allowances for loan losses at a level that is adequate to absorb estimated incurred losses, but the 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 the estimate of the losses related to the risk sharing on FFEL program loans only. The provision for loan losses on FFEL program loans and FFEL program loans in a cure status is recorded as follows:

- FFEL program loans - The allowance for loan losses represents the 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 – A loan is considered to be in a 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. A provision for loan losses is recorded on any loans that have been in a cure status for greater than 24 months or any loans considered incurable.

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

Lastly, non-performing student loans are written off. The Agency sends 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 the estimate of the losses related to the risk associated with non-FFEL program loans, such as private student loans.

- A provision for loan losses on PHEAA's PA Forward Private Student Loan Program loans is determined by segregating these loans into homogenous student loan pools. Each homogenous student loan pool is assigned an expected base loss rate factor and an unemployment rate factor, and the product of these factors are applied to each homogenous student loan pool. PHEAA monitors unemployment trends for the Commonwealth as a majority of the PA Forward Private Student Loan Program loans are for students who live or attend school in Pennsylvania.
    - Any loan that reaches 180 days delinquent after receiving a Final Demand Letter will be considered in default. Loans are eligible for final charge off three years from the date the loan defaulted or three years from the date of the last payment if payments were made following default.
- A provision for loan losses on other program loans is recorded as follows:
    - Private student loans – a provision for loan losses on private student loans is recorded when the student loan payment status is no longer current (payments are more than 120 days past due), when the student loans are expected to default or when the student loan is non-performing.
        - The student loans formerly guaranteed by The Education Resource Institute, Inc. (TERI) are included with the private student loans. A provision for loan losses is recorded on 100% of the TERI

student loan balances that have a payment delinquency status of 121 days and greater or 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 PHEAA and the HEAL supplemental student loans are private student loans without a guarantee. A provision for loan losses is recorded 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.

- Non-performing student loans are written off. The Agency sends 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, expenses related to risk sharing on defaults is recorded in the provision for loan losses and the expenses related to servicing deficiencies are recorded in "Other operating expenses" on the Statements of Revenues, Expenses and Changes in Net Position.

Capital Assets, net

Capital assets are reported at cost net of depreciation and amortization. Assets that cost $10,000 or more are capitalized and amounts under that threshold are expensed.

Assets held under capital leases are reported at the present value of minimum lease payments net of amortization. Assets held under capital leases and leasehold improvements are amortized based on the straight-line method over the shorter of the lease term or the estimated useful life of the asset.

The Agency purchases software and develops software for internal use. Software is capitalized if the per unit costs, based on per license fee, is $10,000 or more. Improvements or additions to existing software that constitute a capital outlay and increase the value or life of an existing asset by 25% or more of the original cost or life as a betterment, are capitalized as an addition to the value of the existing asset. The development of software involves three phases: preliminary project phase, application development phase and post-implementation/operation phase. The costs associated with the preliminary project and the post-implementation/operation phases are expensed. The costs associated with the application development phase are capitalized. 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.

Capital assets are depreciated or amortized, using the straight-line method, over the following estimated useful lives:

- Buildings and improvements — 7 - 40 years
- Furniture, furnishings and equipment — 5 - 10 years
- Software (purchased and developed internally) — 4 - 10 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). Amortization of the deferred gain or loss on bond refunding is 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, in varying amounts based upon years of service, and may carry forward up to 45 days of unused annual leave at the end of each calendar year. The Agency pays 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. The Agency pays employees a portion of accumulated sick leave at retirement based upon a formula. The estimated amounts payable under these arrangements are included in "Accrued expenses" on the Statements of Net Position.

Operating Revenues and Expenses

Operating revenues include net interest revenue earned and fees earned from providing services. Operating expenses include the costs of providing services and operating all programs. The Agency does not report the grants received and the grants and financial aid disbursed as a component of operating income.

Revenue Recognition

***Student Loan Interest Revenue, net***

Student loan interest revenue is recognized as earned, net of consolidation rebate fees, government interest, special allowance income or expense, amortization of premiums and discounts on student loan purchases, and write offs and recoveries.

The Agency is 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. 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.

The Agency earns interest subsidies and special allowance payments on certain FFEL program student loans within the 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 premiums or discounts 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 premiums or discounts on student loan purchases are amortized over the estimated life of the student loan portfolio.

***Servicing Fees***

Servicing fee revenue is earned by servicing student loans owned by third parties. Servicing fees are recognized as revenue when the contractual services have been provided and any unbilled amounts are recorded as accounts receivable.

***Retention of Collections on Defaulted Loans, net***

As a FFEL program guarantor, the Agency facilitates the guarantee of 97% to 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, the Agency continues to try to collect on the loan and revenue is earned on the collection of defaulted loans. For rehabilitated loan sales on and after July 1, 2014, the Agency pays 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, the Agency 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, the Agency purchases rehabilitated student loans and sells them to eligible lenders, sometimes at a discount.

***Federal Fees***

The Agency earns account maintenance fees from operating the guaranty agency. ED pays the Agency 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. The account maintenance fees are classified as "Federal fees" on the Statements of Revenues, Expenses and Changes in Net Position.

***Commonwealth of Pennsylvania and Federal Grant Revenues***

Commonwealth and federal grants are non-exchange transactions. The receipts are used as a source of funds to disburse grants and financial aid. In accordance with legislation or grant agreements, the Agency is required to disburse grant funding on specific purposes, but generally, specific time requirements are not applicable. Accordingly, the entire amount is recognized as revenue when received.

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

Student Loan Financings and Other Financings Interest Expense

Student loan financings and other financings interest expense is recorded based upon contractual interest rates. Interest expense is recorded net of the amortization of bond discounts and premiums and the amortization of deferred gains and losses on bond refundings.

Recently Issued GASB Pronouncements

During 2020, the GASB issued Statement No. 95 – *Postponement of the Effective Dates of Certain Authoritative Guidance*. The Agency is required to adopt Statement No. 95 immediately. The effective dates of the accounting pronouncements listed below have been updated as applicable.

During 2017, the GASB issued Statement No. 87 - *Leases.* The objective of this Statement is to improve accounting and financial reporting for leases by governments. This Statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases. 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. The requirements of GASB Statement No. 87 are effective for the Agency's fiscal year ending June 30, 2022.

During 2020, the GASB issued Statement No. 93 – *Replacement of Interbank Offered Rates*. Because of global reference rate reform, interbank offered rates (IBOR) – most notably, the London InterBank Offered Rate (LIBOR), are expected to cease to exist in its current form at the end of 2021. Governments will need to amend or replace financial instruments for the purpose of replacing IBOR's by either changing the reference rate or adding or changing fallback provisions related to the reference rate. The objective of this Statement is to address the accounting and financial reporting implications that result from the replacement of an IBOR. The requirements of GASB Statement No. 93 are effective for the Agency's fiscal year ending June 30, 2023.

During 2020, the GASB issued Statement No. 96 – *Subscription-Based Information Technology Arrangements*. Subscription-based information technology arrangements (SBITAs) provide governments with access to vendors' IT software and associated tangible capital assets for subscription payments without granting governments perpetual license or title to the IT software and associated tangible capital assets. The objectives of this Statement are to establish uniform accounting and financial reporting requirements for SBITAs, improve the comparability of financial statements among governments that have entered into SBITAs, and enhance the understandability, reliability, relevance, and consistency of information about SBITAs. The requirements of this Statement are effective for the reporting periods beginning after June 15, 2022, or in other words, for the Agency's fiscal year ending June 30, 2023.

Currently, management is evaluating the impact of these Statements on the financial statements.

## Note 3 – Federal Student Loan Reserve Fund (Federal Fund) and Assets Held for the U.S. Department of Education

Under HEA, the Agency acts as a fiduciary in managing the assets of the Federal Fund. The following table shows the detail of the assets and liabilities held for ED in the Federal Fund.

(Dollars in thousands)

| As of June 30, | | **2020** | | 2019 |
|---|---|---|---|---|
| Assets: | | | | |
| Cash | **$** | **60,097** | $ | 21,350 |
| Receivable from the U.S. Department of Education | | **35,322** | | 61,873 |
| Other receivables | | **389** | | 788 |
| Total assets | | **95,808** | | 84,011 |
| Liabilities: | | | | |
| Accounts payable and accrued expenses | | **8,303** | | 2,002 |
| Payable to the U. S. Department of Education | | **1,107** | | - |
| Amounts payable to PHEAA | | **200,565** | | 203,467 |
| Total liabilities | | **209,975** | | 205,469 |
| Net liabilities | **$** | **(114,167)** | $ | (121,458) |

As of June 30, 2020 and June 30, 2019, the Agency reported \$86.4 million and \$82.0 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. This amount is the difference between the Federal Fund's total assets and total liabilities, excluding amounts payable to PHEAA.

## Note 4 – Cash, Cash Equivalents and Investments

Overview

The Agency manages the 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 the Agency's 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

In order of priority, the primary objectives of the Agency's investment activities are safety, liquidity, and yield.

Safety of principal is the foremost objective of the Agency's 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, the investment portfolio shall be diversified by the type of investment, issuer, and maturity date.

The liquidity of the investment 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. In addition, 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 management governs the investments by using the "prudent person" rule under the 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, the Agency's 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 the 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, | 2020 | 2019 |
|---|---|---|
| Cash and cash equivalents | **$ 113,328** | $ 103,576 |
| Restricted cash and cash equivalents | **152,257** | 153,097 |
| Restricted cash and cash equivalents – due to customers | **30,039** | 61,978 |
| Investments | **308,406** | 334,483 |
| Restricted investments | **41,883** | 28,690 |
| Total carrying value | **$ 645,913** | $ 681,824 |

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, 2020 and 2019, the Agency had no Level 3 investments.

The following tables show the fair value and the fair value measurements for the Agency's cash equivalents and investments.

(Dollars in thousands)

| As of June 30, 2020 | Carrying Value | Fair Value | Level 1 | Level 2 |
|---|---|---|---|---|
| Cash equivalents: | | | | |
| Money market funds: | | | | |
| Federated money market funds | **$ 146,178** | **$ 146,178** | **$ 146,178** | **$ -** |
| PFM Government Select Series | **58,265** | **58,265** | **-** | **58,265** |
| Commercial paper | **91,181** | **91,264** | **-** | **91,264** |
| Total cash equivalents | **295,624** | **295,707** | **146,178** | **149,529** |
| Investments: | | | | |
| State Treasury investment pools: | | | | |
| Pool 998 | **118,181** | **118,181** | **-** | **-** |
| Pool 999 | **232,108** | **232,108** | **-** | **-** |
| Total investments | **350,289** | **350,289** | **-** | **-** |
| Total cash equivalents and investments | **$ 645,913** | **$ 645,996** | **$ 146,178** | **$ 149,529** |

(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 |

***Cash Equivalents***

*Money Market Funds*

Federated Money Market Funds – As of June 30, 2020 and 2019, the Agency held positions in various Federated money market funds and the fair values of those funds were $154.2 million and $145.5 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, 2020 and 2019, the Agency held positions in PFM Government Select Series and the fair values were $58.3 million and $52.2 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, 2020, the Agency did not hold any federal agency discount notes. As of June 30, 2019, the Agency held positions in federal agency discounted notes and the fair values were $55.9 million. 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, 2020 and 2019, the Agency held positions in commercial paper and the fair values were $91.3 million and $47.1 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 Treasury Department maintains the State Treasury Investment Pools 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, 2019 (most recent annual report available), Pool 998's asset allocations were 58% invested in fixed income (including cash and cash equivalents) and 42% invested in equities and alternative assets. Pool 998 is benchmarked against a blend of indexes based on the asset class. For instance, for the equity portion, a weighting of 60% is measured against the Russell 3000 Index and 40% is measured against the MCSI ACWI ex U.S. Index and the fixed income portion is measured against the Barclay's Capital U.S. Aggregate Bond Index. As of June 30, 2020 and 2019, the Agency's investments in Pool 998 were $118.2 million and $162.5 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, 2019 (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, 2020 and 2019, the Agency's investments in Pool 999 were $232.1 million and $200.6 million, respectively.

For more information on Pools 998 and 999, see the Pennsylvania Treasury "Annual Investment Report for Fiscal Year Ending June 30, 2019", 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. The Agency manages exposure to interest rate risk by structuring the 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, 2020 and 2019, $303.7 million of the Agency's cash equivalents have maturities of less than one year. As of June 30, 2020 and 2019, $350.3 million and $363.2 million, respectively, of the Agency's 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. The Agency minimizes 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, 2020 and 2019, all of the Agency's investments in commercial paper were rated at least A-1. As of June 30, 2020 and 2019, all of the Agency's investments in money market funds were rated AAAm. As of June 30, 2020 and 2019, 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, the Agency would not be able to recover deposits or collateral securities that are in the possession of an outside party.

As of June 30, 2020, the Agency had $15.1 million of cash deposits with financial institutions of which $14.8 million was in excess of the federal depository insurance limits.

Concentration of Credit Risk

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

As of June 30, 2020, the Agency did not have investments in a single issuer that represented 5% or more of the total cash equivalents and investments. As of June 30, 2019, the Agency's investment in federal agency discount notes (FHLB) represented 8.4% of the total cash equivalents and investments.

## Note 5 – Student Loans Receivable, net

The following table shows the details of the student loans receivable, net.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 |
|---|---|---|
| Student loans receivable: | | |
| FFEL student loans: | | |
| Consolidation | **$ 2,773,262** | **$ 3,168,376** |
| Stafford | **554,835** | **654,414** |
| PLUS | **40,490** | **49,726** |
| SLS | **511** | **1,109** |
| Total FFEL student loans | **3,369,098** | **3,873,625** |
| Private and HEAL student loans: | | |
| Private | **55,949** | **18,964** |
| HEAL | **4,020** | **6,646** |
| Total private and HEAL student loans | **59,969** | **25,610** |
| Total student loans receivable | **3,429,067** | **3,899,235** |
| Student loans purchased at year end and pending conversion | **242** | **-** |
| Unamortized student loan purchase premium | **656** | **1,778** |
| Unamortized student loan purchase discount | **(2,720)** | **(4,332)** |
| Allowance for loan losses | **(4,242)** | **(4,826)** |
| Total student loans receivable, net | **$ 3,423,003** | **$ 3,891,855** |

Allowance for Loan Losses

The following table summarizes the changes in 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 and for the years ended June 30, | **2020** | 2019 |
|---|---|---|
| Balance at beginning of year | **$ 4,826** | $ 6,131 |
| Provision for losses - FFEL program loans | **1,031** | 3,703 |
| Provision for losses - Other program loans (Non-FFEL) | **852** | (268) |
| Charge-offs - FFEL program loans | **(2,218)** | (4,870) |
| Charge-offs - Other program loans (Non-FFEL) | **(249)** | 130 |
| Balance at end of year | **$ 4,242** | $ 4,826 |

## Note 6 – 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, 2020 | Beginning Balance | Additions | Retirements | Ending Balance |
|---|---|---|---|---|
| Capital assets: | | | | |
| Land | $ 8,044 | $ 135 | $ - | $ 8,179 |
| Buildings and improvements | 74,192 | 1,268 | (1,973) | 73,487 |
| Software | 93,774 | 41,644 | (4,986) | 130,432 |
| Information technology equipment | 28,894 | 4,710 | (1,394) | 32,210 |
| Other equipment | 16,735 | 703 | (2,836) | 14,602 |
| Total capital assets | 221,639 | 48,460 | (11,189) | 258,910 |
| Less accumulated depreciation and amortization: | | | | |
| Buildings and improvements | (47,830) | (2,059) | 1,476 | (48,413) |
| Software | (40,459) | (13,324) | 4,948 | (48,835) |
| Information technology equipment | (16,830) | (4,381) | 1,207 | (20,004) |
| Other equipment | (13,164) | (1,161) | 2,502 | (11,823) |
| Total accumulated depreciation and amortization | (118,283) | (20,925) | 10,133 | (129,075) |
| Total capital assets, net | $ 103,356 | $ 27,535 | $ (1,056) | $ 129,835 |

Depreciation expense for the years ended June 30, 2020 and 2019 was $20.9 million.

## Note 7 – Notes and Bonds Payable and Other Financings

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

| (Dollars in thousands)<br>As of and for the year ended June 30, 2020 | 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 1.03% as of June 30, 2020 and 3.14% as of June 30, 2019. | $ 3,644,971 | $ - | $ (540,773) | $ 3,104,198 | $ - |
| Deferred gain on bond refunding of student loan floating rate notes | 14,472 | 63 | (13,666) | 869 | - |
| Deferred loss on bond refunding of student loan floating rate notes | (1,967) | 685 | - | (1,282) | - |
| Discount on student loan floating rate notes | (4,271) | 1,876 | - | (2,395) | - |
| Education loan revenue bonds, due 2025-2047 at fixed interest rates of 2.45%-5.00%. | - | 47,570 | (200) | 47,370 | - |
| Premium on education loan revenue bonds | - | 2,426 | (86) | 2,340 | - |
| Student loan auction rate security bonds due 2042, at an interest rate of 1.69% as of June 30, 2020 and 3.34% as of June 30, 2019. | 9,400 | - | (1,400) | 8,000 | - |
| Student loan financings, due on demand, at an an interest rate of 0.98% as of June 30, 2020 and 3.24% as of June 30, 2019. Unused portion was $165.9 million as of June 30, 2020. | 40,000 | 64,612 | (20,500) | 84,112 | 84,112 |
| Total student loan financings | 3,702,605 | 117,232 | (576,625) | 3,243,212 | 84,112 |
| Other financings: | | | | | |
| Unamortized premium on capital acquisition refunding bonds | 685 | - | (294) | 391 | - |
| Financed purchase agreement, due 2023, at zero percent as of June 30, 2020. | - | 1,792 | - | 1,792 | 448 |
| Term financings, due 2029, at zero percent as of June 30, 2020 and June 30, 2019. | 6,280 | - | - | 6,280 | - |
| Total other financings | 6,965 | 1,792 | (294) | 8,463 | 448 |
| Total student loan and other financings | $ 3,709,570 | $ 119,024 | $ (576,919) | $ 3,251,675 | $ 84,560 |

The notes and bond indentures, among other things, require PHEAA to comply with various covenants, such as parity ratio requirements and annual financial statement and servicing audits. Student loans and investments collateralize all student loan financings. As of June 30, 2020, $3.5 billion of student loan principal and related interest receivable and $151.8 million of cash equivalents collateralized the $3.2 billion of student loan financings.

As of June 30, 2020, the student loan financings and other financings are non-recourse obligations to PHEAA's unrestricted net position and to the Commonwealth, except for the $84.1 million of student loan financings, which are recourse obligations to PHEAA.

The Agency has two additional lines of credit that had zero balances at June 30, 2020. The total unused portion of these lines of credit at June 30, 2020 was $360.0 million. On July 1, 2020, one line of credit was amended and the available balance was reduced by $50.0 million, from $150.0 million to $100.0 million.

Student Loan Financings

For the year ended June 30, 2020, the student loan financings had a net decrease of $459.4 million that was primarily due to debt payments of $562.9 million and scheduled amortization of deferred gains and losses on bond refundings and scheduled amortization of discounts and premiums of $11.0 million. These decreases were offset by the issuance of education loan revenue bonds and drawdowns on the line of credit for the purchase of rehabilitated loans and to fund the Agency's PA Forward Private Student Loan Program.

In March 2020, the Agency issued, at a premium, Education Loan Revenue Bonds, Senior Series 2020A and Subordinate Series 2020B, Tax-Exempt AMT (alternative minimum tax) Fixed Rate Bonds in the aggregate principal amounts of $41.9 million and $5.7 million, respectively. The proceeds are being issued for the principal purpose of repaying or refinancing sums borrowed by the Agency to finance eligible loans, (ii) originating and financing eligible loans, (iii) depositing to the capitalized interest and debt service reserve funds, and (iv) paying certain costs of issuance of the bonds. Of the $41.9 million of Series 2020A bonds, $10.3 million of Series 2020A bonds were issued with fixed interest rates of 5% and final maturity dates of June 1, 2025, 2026, 2027, 2028 and 2029, and $31.6 million of Series 2020A bonds were issued with a fixed interest of 2.45% and a final maturity date of June 1, 2041. Series 2020B bond was issued with a fixed interest rate of 3.00% and a final maturity of June 1, 2047.

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. As of June 30, 2020, the defeased bonds had an outstanding balance of $9.6 million.

During the year ended June 30, 2020, the Agency entered into a financed purchase agreement for information technology equipment in the amount of $1.8 million. Four equal payments are due annually with 0% interest beginning in September 2020, with final maturity in 2024.

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 |
| 2021 | $ 84,112 | $ 34,108 | $ 448 | $ - |
| 2022 | - | 33,501 | 448 | - |
| 2023 | - | 33,501 | 448 | - |
| 2024 | - | 33,501 | 448 | - |
| 2025 | 1,500 | 33,495 | - | - |
| 2026-2030 | 118,988 | 164,294 | 6,280 | - |
| 2031-2035 | - | 158,201 | - | - |
| 2036-2040 | 888,597 | 128,701 | - | - |
| 2041-2045 | 1,231,623 | 69,624 | - | - |
| 2046-2050 | 20,550 | 48,757 | - | - |
| 2051-2055 | - | 48,099 | - | - |
| 2056-2060 | 100,968 | 45,799 | - | - |
| 2061-2065 | - | 44,391 | - | - |
| 2066-2069 | 797,342 | 11,408 | - | - |
| | $ 3,243,680 | $ 887,380 | $ 8,072 | $ - |

Other than the education loan revenue bonds, the student loan financings are variable-rate debt, which have interest rates that reset on various dates. As of June 30, 2020, interest rates on $8.0 million reset based upon auctions every 28 days and $3.2 billion was indexed to the 1-month or 3-month LIBOR.

## Note 8 – Retirement Benefits

Plan Description

The Agency contributes 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 had 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 was effective July 1, 2019.

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.

The defined contribution only plan does not have a benefit accrual rate. Members choosing this option retire with their contributions, employer contributions if vested, and any investment gains on those contributions. These members contribute 7.5% of their salary.

Funding Policy

The State Employees Retirement Code (SERC) 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.

The following table presents the employer contribution rates for the years ended June 30, 2020 and 2019.

| For the years ended June 30, | **2020** | 2019 |
|---|---|---|
| "A"Class of Service Contribution Rate | **28.84%** | 27.71% |
| "AA" Class of Service Contribution Rate | **36.04%** | 34.63% |
| "A-3" Class of Service Contribution Rate | **24.92%** | 23.94% |
| "A-4" Class of Service Contribution Rate | **24.92%** | 23.94% |
| "A-5" Class of Service Contribution Rate | **19.18%** | 18.42% |
| "A-6" Class of Service Contribution Rate | **19.18%** | 18.42% |
| Defined Contribution Only Plan | **19.12%** | 18.39% |

For the years ended June 30, 2020 and 2019, the Agency contributed 2.25%, 2.00% and 3.5% to the defined contribution plan portion for Class A-5 members, Class A-6 members and the defined contribution only plan members. The remaining percentages were contributions to the defined benefit plan. Act 2017-5 requires employers to contribute to the defined benefit fund for all employees, including those who choose the defined contribution only plan.

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 PHEAA with the information and the amounts presented are considered elements of the financial statements of SERS and PHEAA. In some cases, SERS provided the total plan-level information only, in which case, the Agency applied its proportionate share percentage in to order to calculate the required amounts under GASB. As stated previously in the "Plan Description", separately issued financial statements for SERS can be obtained from SERS management at www.sers.pa.gov.

***PHEAA's Allocation Percentage Methodology***

The allocation percentage assigned to PHEAA was based on a projected-contribution method. This methodology applies the most recently calculated contribution rates for the Commonwealth's 2020-2021 and 2019-2020 fiscal years, from the December 31, 2019 and 2018 funding valuation, to the expected funding payroll for the allocation of the calendar year 2019 and 2018 amounts.

The amounts assigned to PHEAA represent its 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. PHEAA's allocation percentages have been rounded for presentation purposes, therefore amounts presented in the following tables may result in immaterial differences due to this rounding.

(Dollars in thousands)

| As of June 30, 2020 | |
|---|---|
| Projected contributions, July 1, 2020 through June 30, 2021 | **$ 43,498** |
| Total projected contributions, July 1, 2020 through June 30, 2021 | **$ 2,243,324** |
| PHEAA's allocation percentage | **1.94%** |

(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 |
| PHEAA's allocation percentage | | 2.11% |

***Proportionate Share of Net Pension Liability***

As of June 30, 2020, the net pension liability was measured as of December 31, 2019, 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, 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. The SERS valuation measurement dates of December 31, 2019 and 2018 were not the same as PHEAA's fiscal years end of June 30, 2020 and 2019, respectively.

The following table presents the calculation of PHEAA's proportionate share of net pension liability as of June 30, 2020 and 2019. 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, | | 2020 | | 2019 |
|---|---|---|---|---|
| SERS collective net pension liability | **$** | **18,177,995** | $ | 20,831,021 |
| PHEAA's allocation percentage | | **1.94%** | | 2.11% |
| PHEAA's proportionate share of net pension liablity | **$** | **352,470** | $ | 438,740 |

<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. In June 2019, the SERS board of directors approved a reduction in the assumed investment rate of return from 7.25% to 7.125%.

The following methods and assumptions were used in the GASB 68 Valuation for the December 31, 2019 and 2018 measurement dates:

- Actuarial cost method – entry age
- Investment rate of return – 7.125% net of expenses including inflation for 2019 and 7.25% net of expenses including inflation for 2018
- 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% | 7.25% |
| Global public equity | 48% | 5.15% |
| Real estate | 12% | 5.26% |
| Multi-strategy | 10% | 4.44% |
| Fixed income | 11% | 1.26% |
| Cash | 3% | 0.00% |
| Total | 100% | |

***Discount Rate***

According to the GASB 68 Valuation, the discount rate used to measure the total pension liability was 7.125%. 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 tables present PHEAA's proportionate share of the net pension liability calculated using the discount rate of 7.125% and 7.25% as of June 30, 2020 and 2019, respectively, 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)<br>As of June 30, 2020 | 1% decrease to 6.125% | Current discount rate of 7.125% | 1% increase to 8.125% |
|---|---|---|---|
| PHEAA's net pension liability | **$ 447,870** | **$ 352,470** | **$ 270,795** |

| (Dollars in thousands)<br>As of June 30, 2019 | 1% decrease to 6.25% | Current discount rate of 7.25% | 1% increase to 8.25% |
|---|---|---|---|
| PHEAA's net pension liability | $ 538,737 | $ 438,740 | $ 353,048 |

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 deferred inflows of resources related to pensions.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 |
|---|---|---|
| Deferred outflows of resources: | | |
| Differences between expected and actual experience | **$ 4,395** | $ 6,584 |
| Net difference between projected and actual investment earnings on pension plan investments | **-** | 42,687 |
| Changes in assumptions | **13,582** | 11,689 |
| Differences between employer contributions and proportionate share of contributions | **2,361** | 1,939 |
| Changes in proportion | **2,819** | 12,760 |
| Contributions made subsequent to the measurement date | **22,426** | 22,684 |
| Total deferred outflows of resources | **$ 45,583** | $ 98,343 |

(Dollars in thousands)

| As of June 30, | **2020** | 2019 |
|---|---|---|
| Deferred inflows of resources: | | |
| Differences between expected and actual experience | **$ 2,387** | $ 4,754 |
| Net difference between projected and actual investment earnings on pension plan investments | **25,138** | - |
| Differences between employer contributions and proportionate share of contributions | **101** | 332 |
| Changes in proportion | **60,335** | 47,276 |
| Total deferred inflows of resources | **$ 87,961** | $ 52,362 |

*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, 2021. The remaining net amounts of deferred outflows of resources and deferred inflows of resources related to the items previously reported as of June 30, 2020 will be recognized in pension expense in future years as follows:

(Dollars in thousands)

| For the years ending June 30, | 2021 | 2022 | 2023 | 2024 | 2025 | Thereafter |
|---|---|---|---|---|---|---|
| Net amortization | $ (14,596) | $ (20,115) | $ (10,777) | $ (18,348) | $ (968) | $ - |

***Pension Expense***

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

(Dollars in thousands)

| For the years ended June 30, | | 2020 | | 2019 |
|---|---|---|---|---|
| Pension expense: | | | | |
| Proportionate share of plan pension expense | **$** | **50,272** | $ | 62,865 |
| Net amortization difference between employer contributions and proportionate share of contributions | | **446** | | 146 |
| Net amortization of deferred amounts from changes in proportion | | **(7,368)** | | (312) |
| Total pension expense | **$** | **43,350** | $ | 62,699 |

## Note 9 – Other Postemployment Benefits (OPEB)

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 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 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 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 per bi-weekly pay period for each current REHP eligible active employee during fiscal year ended June 30, 2019 to the REHP Trust. PHEAA and certain other agencies contribute to the REHP Trust 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, 2020 and 2019, PHEAA's contributions were $3.4 million and $3.7 million, respectively. As of June 30, 2020 and 2019, PHEAA 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 unique contribution arrangements 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, 2020 and 2019, PHEAA's allocation percentage was 2.10% and 1.87%, respectively. PHEAA's proportionate share percentages were rounded to the nearest hundredth of a percent; therefore, amounts presented in the following tables may result in immaterial differences due to rounding.

***Proportionate Share of Net OPEB Liability***

As of June 30, 2020, the net OPEB liability was measured as of June 30, 2019, 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, 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. The OPEB valuation measurement dates of June 30, 2019 and 2018 were not the same as PHEAA's fiscal years end of June 30, 2020 and 2019, respectively.

The following table presents the calculation of PHEAA's proportionate share of net OPEB liability as of June 30, 2020 and 2019.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 |
|---|---|---|
| REHP collective net OPEB liability | **$ 10,413,853** | $ 14,682,127 |
| PHEAA's allocation percentage | **2.10%** | 1.87% |
| PHEAA's proportionate share of net OPEB liablity | **$ 218,891** | $ 274,286 |

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 of directors 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, 2019 and 2018 measurement date:

- Actuarial cost method – entry age normal
- Actuarial value of assets – market value of assets on the valuation date
- Census date – December 31, 2018 for June 30, 2019 measurement date and December 31, 2017 for June 30, 2018 measurement date
- Discount rate – 3.5% as of June 30, 2019 and 3.87% as of June 30, 2018
- Inflation – 2.60%
- Investment rate of return – 5.0%
- Medical trend rate – initial - 6.0%/5.9%, ultimate – 4.1%, year reached – 2075 as of June 30, 2019 and initial – 6.2%/5.9%, ultimate – 4.1%, year reached – 2075 as of June 30, 2018
- 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 |
|---|---|---|
| Domestic equity | 47% | 5.6% |
| International equity | 20% | 5.8% |
| Fixed income | 25% | 1.7% |
| Real estate | 8% | 4.6% |
| Cash and cash equivalents | 0% | 0.9% |
| Total | 100% | |

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

The following table presents PHEAA's proportionate share of the net OPEB liability calculated using the discount rate and the medical trend rate as of June 30, 2020 and 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, 2020: | | | |
| Discount rate - 3.50% | **$ 248,343** | **$ 218,891** | **$ 194,238** |
| Medical trend rate - 4.10% | **$ 190,147** | **$ 218,891** | **$ 254,248** |
| As of June 30, 2019: | | | |
| Discount rate - 3.87% | $ 314,237 | $ 274,286 | $ 241,368 |
| Medical trend rate - 4.10% | $ 235,451 | $ 274,286 | $ 322,553 |

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 deferred inflows of resources related to OPEB.

(Dollars in thousands)

| As of June 30, | **2020** | 2019 |
|---|---|---|
| Deferred outflows of resources: | | |
| Changes in assumptions | **$ 7,002** | $ - |
| Change in proprotionate share and differences between actual and proportionate share of employer contributions | **34,682** | - |
| Contributions made subsequent to the measurement date | **3,430** | 3,723 |
| Total deferred outflows of resources | **$ 45,114** | $ 3,723 |

(Dollars in thousands)

| As of June 30, | | **2020** | | 2019 |
|---|---|---|---|---|
| Deferred inflows of resources: | | | | |
| Changes in assumptions | **$** | **30,318** | $ | 36,057 |
| Differences between expected and actual experience | | **162,798** | | 84,007 |
| Net difference between projected and actual investment earnings on OPEB plan investments | | **388** | | 419 |
| Change in proprotionate share and differences between actual and proportionate share of employer contributions | | **334** | | 423 |
| Total deferred inflows of resources | **$** | **193,838** | $ | 120,906 |

*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 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 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, 2021. The remaining net amounts of the deferred outflows of resources and the deferred inflows of resources related to the items previously reported as of June 30, 2020 will be recognized in OPEB expense in future years as follows:

(Dollars in thousands)

| For the years ending June 30, | | 2021 | | 2022 | | 2023 | | 2024 | | 2025 | | Thereafter |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Net amortization | $ | (40,252) | $ | (40,252) | $ | (37,839) | $ | (26,347) | $ | (7,395) | $ | (69) |

***OPEB Expense***

For the years ended June 30, 2020 and 2019, the Agency's OPEB expense was a negative $20.4 million and a negative $4.1 million, respectively.

## Note 10 – Net Position

Net investment in capital assets includes land, buildings and improvements, software, information technology equipment, and other tangible assets used in 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. Net investment in capital assets was $129.8 million as of June 30, 2020 and $103.4 million as of June 30, 2019.

Net position restricted for debt service includes certain funds held in trust in order to comply with various indentures related to the financing of student loan portfolios. Net position restricted for debt service was $368.0 million as of June 30, 2020 and $361.2 million as of June 30, 2019.

Net position restricted for financial aid grant programs include Commonwealth and federal grant receipts that relate to specific programs. The net position is restricted until disbursed for program-related grants. Net position restricted for financial aid grant programs was $42.4 million as of June 30, 2020 and $30.0 million as of June 30, 2019.

Unrestricted net position 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, PHEAA's purpose is to increase higher education opportunities for Pennsylvania residents. Therefore, unrestricted net position is statutorily restricted to that purpose. As a FFEL program guarantor, the Higher Education Amendments of 1998 restricts the Agency's use of net position related to FFEL guaranty activities to fulfilling the guaranty responsibilities and other student financial aid related activities selected by PHEAA. This restriction is consistent with the Agency's statutory purpose and the net position related to those guaranty activities is included in unrestricted net position. As of June 30, 2020, unrestricted net position was a negative $314.1 million of which net position related to the guaranty activities was $172.9 million. 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.

## Note 11 – Servicing Fees

As a servicer, the Agency is responsible for servicing, maintaining custody of, and making collections on student loans. The Agency earns servicing fee revenue by servicing student loans owned by third parties. Revenue earned from loans owned by financial institutions and secondary markets is classified as "Commercial Servicing"; whereas, revenue earned from loans owned by ED are classified as "FLS Servicing". Revenue earned from providing the Agency's proprietary COMPASS system to guarantors and other servicers to use, as well as, not-for-profit servicers who were awarded servicing contracts by ED, is classified as "Remote Servicing". Under servicing agreements, the Agency generally agrees to reimburse customers for any claims, losses, liabilities, or expenses that arise out of or relate to the Agency's acts or omissions with respect to services provided under such agreements. As a result, a provision for estimated claims under the agreements is recorded as "Other operating expenses" in the Statements of Revenues, Expenses and Changes in Net Position.

For the years ended June 30, 2020 and 2019, total servicing revenues were $298.5 million and $297.5 million, respectively. For the years ended June 30, 2020 and 2019, the Agency was servicing on average $376.7 billion and $362.0 billion, respectively, of loans for third party customers. For the years ended June 30, 2020 and 2019, customers using the COMPASS system, serviced on average $90.1 billion and $75.9 billion, respectively, of loans.

For the year ended June 30, 2020, ED provided $208.6 million of servicing revenue, which represents 70% of the total servicing revenue. The next three largest loan-servicing customers provided $26.9 million of servicing revenue, which represented 9% of the total servicing revenue.

For the year ended June 30, 2019, ED provided $201.9 million of servicing revenue, which represents 68% of the total servicing revenue. The next three largest loan-servicing customers provided $31.7 million of servicing revenue, which represented 11% of the total servicing revenue.

## Note 12– Segment Information

The Agency generally finances student loan portfolios by issuing notes, bonds, and other financings. The earnings on the student loan portfolios are pledged to support the debt. These types of notes, bonds, and other financings are limited obligations payable only from the pledged assets. The following tables present the condensed financial information related to this student loan segment of PHEAA's operations.

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

| For the years ended June 30, | 2020 | 2019 |
|---|---|---|
| Interest revenue | $ 121,996 | $ 171,854 |
| Interest expense | (73,440) | (104,432) |
| Net interest revenue | 48,556 | 67,422 |
| Provision for loan losses | (1,802) | (2,598) |
| Net interest revenue after provision for loan losses | 46,754 | 64,824 |
| Total noninterest revenue | 899 | 178 |
| Total operating revenues | 47,653 | 65,002 |
| Total operating expenses | (20,727) | (25,886) |
| Operating income | 26,926 | 39,116 |
| Federal grants | 1,900 | - |
| Transfers to unrestricted net position | (21,971) | (19,788) |
| Change in net position | 6,855 | 19,328 |
| Net position, beginning of year | 361,176 | 341,848 |
| Net position, end of year | $ 368,031 | $ 361,176 |

Statements of Net Position

(Dollars in thousands)

| As of June 30, | 2020 | 2019 |
|---|---|---|
| Current assets: | | |
| Restricted cash and cash equivalents | $ 151,772 | $ 151,934 |
| Student loans receivable | 466,422 | 587,769 |
| Interest income receivable | 87,843 | 89,695 |
| Total current assets | 706,037 | 829,398 |
| Long-term assets: | | |
| Student loans receivable, net | 2,911,174 | 3,244,503 |
| Total long-term assets | 2,911,174 | 3,244,503 |
| Total assets | 3,617,211 | 4,073,901 |
| Deferred outflow of resources: | | |
| Deferred loss on bond refundings | 1,195 | 1,706 |
| Total deferred outflow of resources | 1,195 | 1,706 |
| Current liabilities: | | |
| Accounts payable and accrued expenses | 5,881 | 9,859 |
| Student loan financings | 84,112 | 40,000 |
| Total current liabilities | 89,993 | 49,859 |
| Long-term liabilities: | | |
| Student loan financings, net | 3,159,513 | 3,650,100 |
| Total long-term liabilities | 3,159,513 | 3,650,100 |
| Total liabilities | 3,249,506 | 3,699,959 |
| Deferred inflow of resources: | | |
| Deferred gain on bond refundings | 869 | 14,472 |
| Total deferred inflow of resources | 869 | 14,472 |
| Net position | | |
| Restricted for debt service | 368,031 | 361,176 |
| Total net position | $ 368,031 | $ 361,176 |

Statements of Cash Flows

(Dollars in thousands)

| For the years ended June 30, | 2020 | 2019 |
|---|---|---|
| Net cash provided by operating activities | **$ 555,491** | $ 817,443 |
| Net cash used in noncapital financing activities | **(557,643)** | (814,813) |
| Net cash provided by investing activities | **1,990** | 3,312 |
| Net change in restricted cash and cash equivalents | **(162)** | 5,942 |
| Restricted cash and cash equivalents, beginning of year | **151,934** | 145,992 |
| Restricted cash and cash equivalents, end of year | **$ 151,772** | $ 151,934 |

There are twenty separate trusts with parity ratios, a ratio of assets to liabilities, and two of the twenty trusts have minimum parity ratio requirements. As of June 30, 2020, the two trusts complied with the minimum parity ratio requirements.

## Note 13 – Blended Component Units

The PHEAA Student Loan Trusts include 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.

The following statements present the condensed information for the blended component units.

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

| For the years ended June 30, | 2020 | 2019 |
|---|---|---|
| Interest revenue | **$ 105,582** | $ 147,178 |
| Interest expense | **(63,192)** | (87,825) |
| Net interest revenue | **42,390** | 59,353 |
| Provision for loan losses | **(819)** | (2,800) |
| Net interest revenue after provision for loan losses | **41,571** | 56,553 |
| Noninterest revenue | **-** | 29 |
| Total operating revenues | **41,571** | 56,582 |
| Total operating expenses | **(16,964)** | (22,463) |
| Operating income | **24,607** | 34,119 |
| Transfers to unrestricted net position | **(14,758)** | (18,698) |
| Change in net position | **9,849** | 15,421 |
| Net position, beginning of year | **261,925** | 246,504 |
| Net position, end of year | **$ 271,774** | $ 261,925 |

Statements of Net Position

(Dollars in thousands)

| As of June 30, | 2020 | 2019 |
|---|---|---|
| Current assets: | | |
| Restricted cash and cash equivalents | **$ 74,014** | $ 92,183 |
| Student loans receivable | **419,462** | 529,340 |
| Interest income receivable | **77,214** | 81,831 |
| Total current assets | **570,690** | 703,354 |
| Long-term assets: | | |
| Student loans receivable, net | **2,459,284** | 2,801,096 |
| Total long-term assets | **2,459,284** | 2,801,096 |
| Total assets | **3,029,974** | 3,504,450 |
| Total deferred outflow of resources | **1,195** | 1,706 |
| Current liabilities: | | |
| Accounts payable and accrued expenses | **3,897** | 6,508 |
| Total current liabilities | **3,897** | 6,508 |
| Long-term liabilities: | | |
| Student loan financings, net | **2,754,629** | 3,223,251 |
| Total long-term liabilities | **2,754,629** | 3,223,251 |
| Total liabilities | **2,758,526** | 3,229,759 |
| Total deferred inflow of resources | **869** | 14,472 |
| Net position: | | |
| Restricted for debt service | **271,774** | 261,925 |
| Total net position | **$ 271,774** | $ 261,925 |

Statements of Cash Flows

(Dollars in thousands)

| For the years ended June 30, | 2020 | 2019 |
|---|---|---|
| Net cash provided by operating activities | **$ 541,318** | $ 496,459 |
| Net cash used in noncapital financing activities | **(560,929)** | (509,236) |
| Net cash provided by investing activities | **1,442** | 2,373 |
| Net change in restricted cash and cash equivalents | **(18,169)** | (10,404) |
| Restricted cash and cash equivalents, beginning of year | **92,183** | 102,587 |
| Restricted cash and cash equivalents, end of year | **$ 74,014** | $ 92,183 |

## Note 14 – Risk Management and Contingencies

Risk Management

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.

Regulatory Environment

The current heightened regulatory environment for student and consumer lenders and servicers has resulted in significant additional governmental scrutiny, and the Agency 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, the Agency has received formal and informal inquiries, subpoenas, and civil investigative demands from various government regulatory and investigatory authorities about PHEAA, including PHEAA's loans serviced or owned, operations, borrowers, or compliance with laws, rules, regulations or standards. PHEAA expects 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 Agency operations, financial condition, cash flows and/or reputation. Any determination that Agency operations or activities or the activities of 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 the Agency's 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 the Agency's 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 the Agency to incur substantial costs, require changes to operating or servicing practices, or create negative publicity, which could also harm the Agency's respective operations, financial condition, business relationships or reputation. To date, there have been no material supervisory or enforcement actions or findings.

Federal Grants

Federal programs in which the Agency participates are subject to audit in accordance with the provisions of the U.S. Office of Management and Budget's (OMB) Uniform Guidance. 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, PHEAA operations in current and prior years are subject to audit. Management believes the Agency is in substantial compliance with applicable federal regulations and that any adjustment because of future audits will not be material.

Litigation

The Agency is involved in various legal matters in the normal course of business. The Agency has 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, 2020 and through the date of this report.

## Note 15 – Subsequent Event

Management has evaluated subsequent events through September 17, 2020, the date through which procedures were performed to prepare the financial statements. An outbreak of a new coronavirus, detected in China in December 2019, spread internationally in the first quarter of calendar year 2020 causing widespread disruption of the global economy and a rise in market volatility. Health officials have declared this to be a pandemic. The course of the pandemic and its ultimate effect on the United States, the global economy and markets are not fully known at this time. Management's evaluation is ongoing and it is not possible to predict the extent of the effect that the pandemic may have on the Agency's financial position as the financial environment continues to change.

## Required Supplementary Information

Pension

The schedules that follow are required supplementary information and are presented as of and for the year ended December 31, 2019 (**measurement date**) and as of and for the year ended June 30, 2020 (**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 |
|---|---|---|---|---|---|
| **2019** | **1.94%** | **$ 352,470** | **$ 142,384** | **247.5%** | **63.1%** |
| 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 | Contributions excess (deficiency) | PHEAA's covered payroll | PHEAA's contributions as a percentage of covered payroll |
|---|---|---|---|---|---|
| **2020** | **$ 41,261** | **$ 41,261** | **$ -** | **$ 139,792** | **29.5%** |
| 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 PHEAA can compile a full 10-year trend of information, PHEAA is only presenting the information for those years for which information was available.

***Changes in Assumptions***

The investment rate of return changed 7.25% as of June 30, 2019 to 7.125% as of June 30, 2020.

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, 2019 (**measurement date**) and as of and for the year ended June 30, 2020 (**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 |
|---|---|---|---|---|---|
| **2019** | **2.10%** | **$ 218,891** | **$ 102,897** | **212.7%** | **3.8%** |
| 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 | Contributions excess (deficiency) | PHEAA's covered payroll | PHEAA's contributions as a percentage of covered payroll |
|---|---|---|---|---|---|
| **2020** | **$ 3,430** | **$ 3,430** | **$ -** | **$ 99,280** | **3.5%** |
| 2019 | 3,723 | 3,723 | - | 102,897 | 3.6% |
| 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 PHEAA can compile a full 10-year trend of information, PHEAA is only presenting the information for those years for which information was available.

***Changes in Assumptions***

The discount rate changed from 3.87% as of June 30, 2019 to 3.50% as of June 30, 2020. In addition, the medical trend information was updated.

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.