Quarterly Financial Report
September 30, 2016 and 2015

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

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

About PHEAA

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

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

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

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

Public Service Benefits

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

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015	2014
Self-funded				
Pennsylvania State Grant Program Supplement	$	**-**	-	20,000
Costs of operating state and federal governmental programs		**4,542**	3,437	3,664
Pennsylvania Distance Education Program Supplement, net of refunds		**1,522**	937	-
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program Supplement, net of refunds		**1,377**	738	(113)
Other public service activities and outreach		**774**	659	625
		8,215	5,771	24,176
Financial support funded by our business partners				
Keystone loan program origination fees and benefits paid on behalf of borrowers		**1**	1	2
	$	**8,216**	5,772	24,178

- On June 16, 2016, the Board of Directors approved that the President/Chief Executive Officer be given the authority to allocate funds to the following programs for fiscal year 2016-17:
  - Pennsylvania State Grant Program - Up to $125.0 million;
  - Pennsylvania Distance Education Program - $10.0 million; and
  - Pennsylvania Targeted Industry Cluster Certificate Scholarship Program - $6.0 million.

- On July 12, 2016, the Commonwealth's Enacted Budget for fiscal year 2016-17 (Senate Bill No. 1073, printer's number 2009) ("Enacted Budget") became law (Act 16A). The Enacted Budget allocates funding levels to the following programs for fiscal year 2016-17:
  - Pennsylvania State Grant Program - $272.9 million;
  - Institutional Assistance Grant Program - $25.7 million;
  - Matching Funds Grant Program - $12.5 million;
  - Pennsylvania Ready to Succeed Scholarship Program - $5.0 million;
  - Higher Education for the Disadvantaged Program - $2.2 million;
  - Cheyney University Keystone Academy Program - $1.8 million;
  - Horace Mann Bond-Leslie Pickney Hill Scholarship for outreach and recruitment activities at Lincoln and Cheyney Universities Program - $697 thousand;
  - Pennsylvania Internships Program Grants - $350 thousand; and
  - Higher Education of Blind or Deaf Program - $47 thousand.

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

- The Pennsylvania State Grant Program is the largest of the Commonwealth supported student aid programs with approximately 134 thousand recipients and the maximum award is $4,378 for the 2016-2017 award year. As of September 30, 2016, we transferred $43.5 million to the Pennsylvania State Grant Program Supplement fund, but transferred zero to the Pennsylvania State Grant Program. As of September 30, 2016, we transferred $10.0 million to the Pennsylvania Distance Education Program and disbursed $1.5 million, net of refunds, from the program. As of September 30, 2016, we transferred $6.0 million to the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program, and disbursed $1.4 million, net of refunds, from the program.

  During the 2015-2016 award year, the Pennsylvania State Grant Program supported approximately 154 thousand recipients and the maximum award is $4,340. During the 2015-2016 award year, the Board of Directors approved and PHEAA supplemented a $125.0 million allocation to the Pennsylvania State Grant Program Supplement, a $10.0 million allocation to the Pennsylvania Distance Education Program and a $6.0 million allocation to the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program.

  During the 2014-2015 award year, the Pennsylvania State Grant Program supported approximately 174 thousand recipients and the maximum award is $4,011. During the 2014-2015 award year, the Board of Directors approved and PHEAA supplemented a $75.0 million allocation to the Pennsylvania State Grant Program Supplement, a $10.0 million allocation to the Pennsylvania Distance Education Program and a $6.0 million allocation to the Pennsylvania Targeted Industry Cluster Certificate Scholarship Program.

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

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

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

- The Postsecondary Educational Gratuity Program ("PEGP") assists birth or adoptive children of Pennsylvania police officers, firefighters, rescue and ambulance squad members, corrections employees and National Guard members who died in the line of duty since January 1, 1976. The program also includes the birth and adoptive children of Pennsylvania sheriffs, deputy sheriffs and certain other individuals who were on federal or state active military duty who died in the line of duty since September 11, 2001. The PEGP covers all institutional charges for tuition, fees, room and board not covered by other grants and scholarships for students attending public colleges and universities in Pennsylvania.

- The Ready To Succeed Scholarship Program ("RTSS") provides awards to high achieving students whose annual family income does not exceed $110,000. Students must be nominated by their post-secondary institution for participation in the program and the awards from the RTSS can be used to cover tuition, books, fees, supplies, and living expenses.

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

Operations

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Commercial Servicing:					
Client-owned student loans	$	**39,379,597**	40,378,802	43,888,182	45,013,515
PHEAA-owned student loans		**5,719,148**	5,947,255	6,701,455	6,944,630
Total commercial servicing		**45,098,745**	46,326,057	50,589,637	51,958,145
Federal Servicing		**275,704,637**	264,640,157	238,419,422	226,418,604
Remote Servicing:					
Federal Servicing		**36,213,048**	34,189,955	34,223,223	34,117,746
Commercial Servicing		**14,571,574**	13,291,354	11,349,438	10,893,034
Total remote servicing		**50,784,622**	47,481,309	45,572,661	45,010,780
Total servicing		**371,588,004**	358,447,523	334,581,740	323,387,529
Guaranty:					
Original principal outstanding		**28,345,419**	29,013,133	31,175,068	31,898,600
Inventory of defaulted loans		**4,672,366**	4,741,697	5,038,391	5,023,164
Total guaranty		**33,017,785**	33,754,830	36,213,459	36,921,764
Total assets managed	$	**404,605,789**	392,202,353	370,795,199	360,309,293

Servicing Activities

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

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

Our FLS line of business services FFEL and William D. Ford ("Direct Loan") program loans, which are owned by the United States Department of Education ("ED"). We are one of four primary servicers that were awarded a contract to service Title IV loans owned by ED and our contract expires on June 16, 2019.

Previously, ED allocated separately new student loan volume to the four primary servicers and to the Not-for-Profit ("NFP") servicers based on certain performance metrics established by ED. On December 18, 2015, President Obama signed H.R. 2029 ("Consolidated Appropriations Act, 2016") into law, which states that the Secretary shall, no later than March 1, 2016, allocate new student loan borrower accounts to eligible student loan servicers on the basis of their performance compared to all student loan servicers utilizing established common metrics, and on the basis of the capacity of each servicer to process new and existing accounts.

For the quarter ended May 31, 2016, ED released the "Explanation of Allocation and Performance Measure Methodology" document, which explains the allocation and performance methodology for each of ED's federal loan servicers. The Explanation of Allocation and Performance Measure Methodology states that ED compiles quarterly customer satisfaction survey scores and default prevention statistics for the members of the federal loan servicer team every six months to determine each servicer's allocation of loan volume. In addition, the Consolidated Appropriations Act, 2016, included a provision related to the allocation of new student loan borrower accounts to federal loan servicers.

The new statutory requirement under the Consolidated Appropriations Act, 2016, prohibits ED from using the contractually established common metrics as used prior to March 1, 2016; that is, by comparing the performance of the Title IV Additional Servicers ("TIVAS") and NFP servicers within their separate performance pools. Instead, the Consolidated Appropriations Act, 2016, requires ED to use an established common metrics to compare servicer performance among "all loan servicers," without regard to their status as a TIVAS or NFP servicer.

To meet the statutory deadline, ED implemented the new allocation percentages for all servicers on March 1, 2016. The new allocation percentages reflect the results of a comparison of performance scores across all servicers using an established metrics. Details regarding the new allocation are available on the Federal Student Aid's website (www.studentaid.ed.gov) under About Us/Data Center/Business Information Resources/Federal Student Aid Contracts/Loan Servicing Contracts/Service Performance Metrics and Allocations (05312016).

On April 4, 2016, ED released the "Solicitation and Statement of Objectives for Phase I of the Federal Aid Servicing Solution". ED conducted Phase I of a two-phase solicitation to acquire a single servicing solution to support the management of Title IV and Title VII financial aid, post loan and grant disbursement. The scope of the potential contract includes but is not limited to loan servicing, loan discharge, loan consolidation, financial reporting, default management, and default collections. On June 30, 2016, ED selected PHEAA to participate in Phase II and on October 26, 2016, ED issued the "Solicitation, Offer and Award" ("Solicitation") for Phase II. The Solicitation states that ED will receive sealed offers until 4:30 pm (Eastern Time) on December 12, 2016. ED anticipates the servicing system contract will be awarded by February 2017. Although the single servicing solution provider will provide all servicing functions including a customer service contact center, additional vendors, referred to in the Solicitation as customer service providers, may be added later, via a separate procurement action to be defined in a future procurement action that ED anticipates to begin within 12 months after award in February 2017.

The Solicitation states that the initial allocations are the division of the portfolio(s) that the primary vendor initially includes in the servicing contract (that vendor's previous portfolio(s) as a Federal Servicer). The initial portfolio shall be divided between the primary vendor and the contact center providers as described in the Solicitation. The division of the portfolio determined which contact center provider will be responsible for direct borrower interactions (incoming/outgoing calls, chat sessions and emails). The primary vendor shall receive 15% of the overall initial portfolio volume for the contact center work and the remaining 85% will be divided amongst the total number of additional contact center providers. All other aspects of servicing for the entire portfolio will be completed by the primary vendor. The division of the 85% will be determined by ED post award once the volume of sub-contractor contact center providers is available. For example, if the primary vendor includes five sub-contracting contact center providers within a proposal, FSA may decide to divide the 85% equally among those vendors at 17% each.

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

Student Loan Holdings

The Student Aid and Fiscal Responsibility Act ("SAFRA") terminated our authority to originate new loans under the FFEL program after June 30, 2010, and currently, all new Stafford, Parent Loan for Undergraduate Students ("PLUS") and Consolidation student loans are originated under the Direct Loan program. We purchase student loans originated under the FFEL program from banks and other lenders from time to time.

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

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

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

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

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

Guaranty Activities

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

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

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

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

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

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

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

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

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

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

For the three months ended September 30, 2016, the average original principal balance outstanding of student loans we guaranteed was $28.7 billion compared to $31.5 billion in 2015 and $34.8 billion in 2014. For more information on the Federal Fund, see the section titled "Federal Student Loan Reserve Fund (Federal Fund)" within the MD&A.

Cohort Default Rate

On October 28, 2009, ED published in the Federal Register the regulations that govern the calculation of the 3-year cohort default rates beginning with the fiscal year 2009 cohort year. Under the provisions, ED calculates a guaranty agency's cohort default rate as the percentage of borrowers in certain FFEL program loans in the cohort who default before the end of the second fiscal year following the fiscal year in which the borrowers entered repayment. This extends the length of time in which a student can default from two to three years. Each year ED publishes cohort default rates based on the percentage of a lender's or guarantor's student borrowers who enter repayment on FFEL program loans during a federal fiscal year (October 1–December 31) and default before the end of the next fiscal year. Our 3-year cohort default rate for fiscal year 2013, the most recent year available, was 8.9%, which was better than the national industry average of 11.3%. Our 3-year cohort default rates for fiscal years 2012 and 2011 were 8.8% and 9.3%, respectively, which were better than the national industry average of 11.8% and 13.7%, respectively.

Description of the Basic Financial Statements

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

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

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

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

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

Condensed Financial Information

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

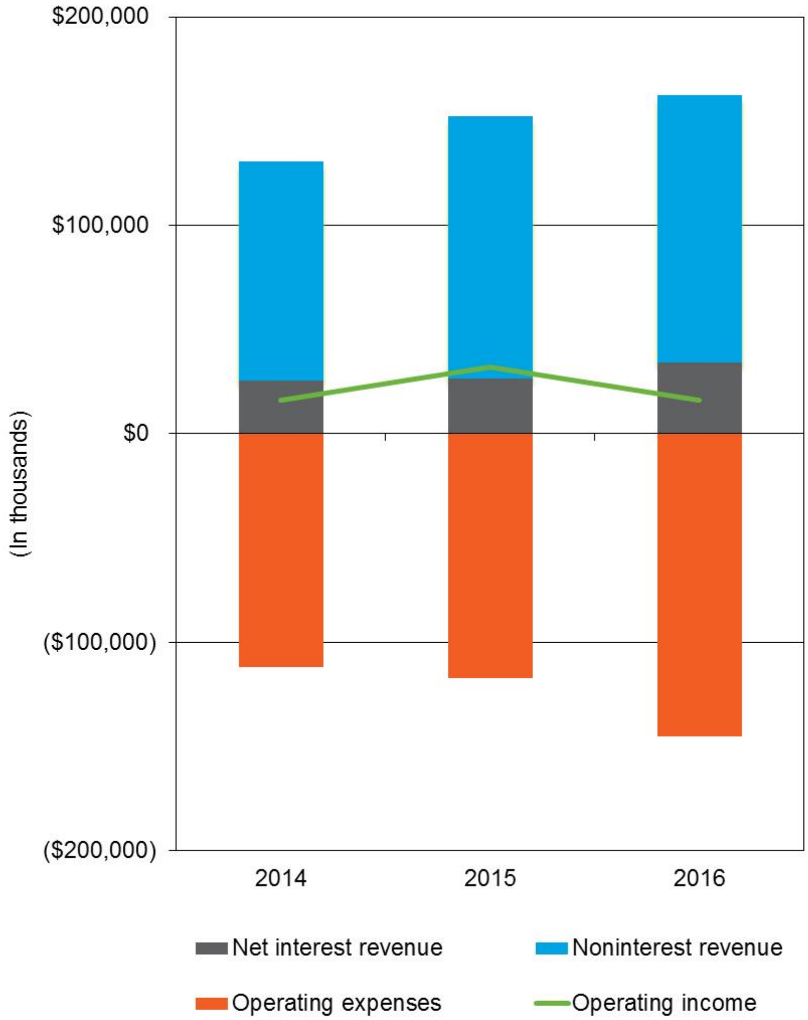
For the three months ended September 30,		**2016**	2015	2014
Student loan interest revenue, net	$	**36,346**	38,692	39,450
Investment interest revenue		**3,939**	(1,519)	330
Interest expense on student loan financings, net		**(6,243)**	(10,472)	(14,185)
Interest expense on other financings		**(115)**	(135)	(155)
Net interest revenue		**33,927**	26,566	25,440
Provision for loan losses		**(522)**	(2,726)	(2,565)
Net interest revenue after provision for loan losses		**33,405**	23,840	22,875
Total noninterest revenue		**128,267**	125,692	105,104
Operating revenues		**161,672**	149,532	127,979
Total operating expenses		**(145,336)**	(117,347)	(111,992)
Operating income		**16,336**	32,185	15,987
Non-operating gains		**27**	24	26
Income before grants and financial aid		**16,363**	32,209	16,013
Total grants and financial aid, net		**15,176**	(12,073)	14,811
Change in net position		**31,539**	20,136	30,824
Net position, beginning of period		**751,711**	804,020	808,766
Net position, end of period	$	**783,250**	824,156	839,590

Statements of Net Position

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Current assets:					
Cash, cash equivalents, and investments (restricted and unrestricted)	$	**1,086,675**	950,524	1,012,832	1,014,822
Student loans receivable, net		**808,975**	962,917	1,128,411	1,095,033
Other assets		**239,108**	237,157	259,562	280,832
Total current assets		**2,134,758**	2,150,598	2,400,805	2,390,687
Long-term assets:					
Student loans receivable, net		**4,888,703**	4,955,122	5,539,037	5,819,102
Other assets		**83,180**	79,087	75,630	75,959
Total long-term assets		**4,971,883**	5,034,209	5,614,667	5,895,061
Total assets		**7,106,641**	7,184,807	8,015,472	8,285,748
Total deferred outflow of resources		**127,947**	128,125	41,783	41,961
Current liabilities:					
Student loan financings		**491,342**	938,213	866,493	903,779
Other liabilities		**238,628**	242,884	207,467	217,216
Total current liabilities		**729,970**	1,181,097	1,073,960	1,120,995
Long-term liabilities:					
Student loan financings, net		**5,095,794**	4,751,841	5,614,262	5,852,233
Net pension liability		**451,784**	440,673	323,866	323,866
Other liabilities		**52,503**	52,316	56,450	56,297
Total long-term liabilities		**5,600,081**	5,244,830	5,994,578	6,232,396
Total liabilities		**6,330,051**	6,425,927	7,068,538	7,353,391
Total deferred inflow of resources		**121,287**	135,294	164,561	170,298
Net position:					
Net investment in capital assets		**83,180**	79,087	75,630	75,959
Restricted for debt service		**301,030**	310,324	276,176	263,381
Restricted for financial aid grant programs		**70,269**	52,079	49,899	61,478
Unrestricted		**328,771**	310,221	422,451	403,202
Total net position	$	**783,250**	751,711	824,156	804,020

Results of Operations

Three months ended September 30

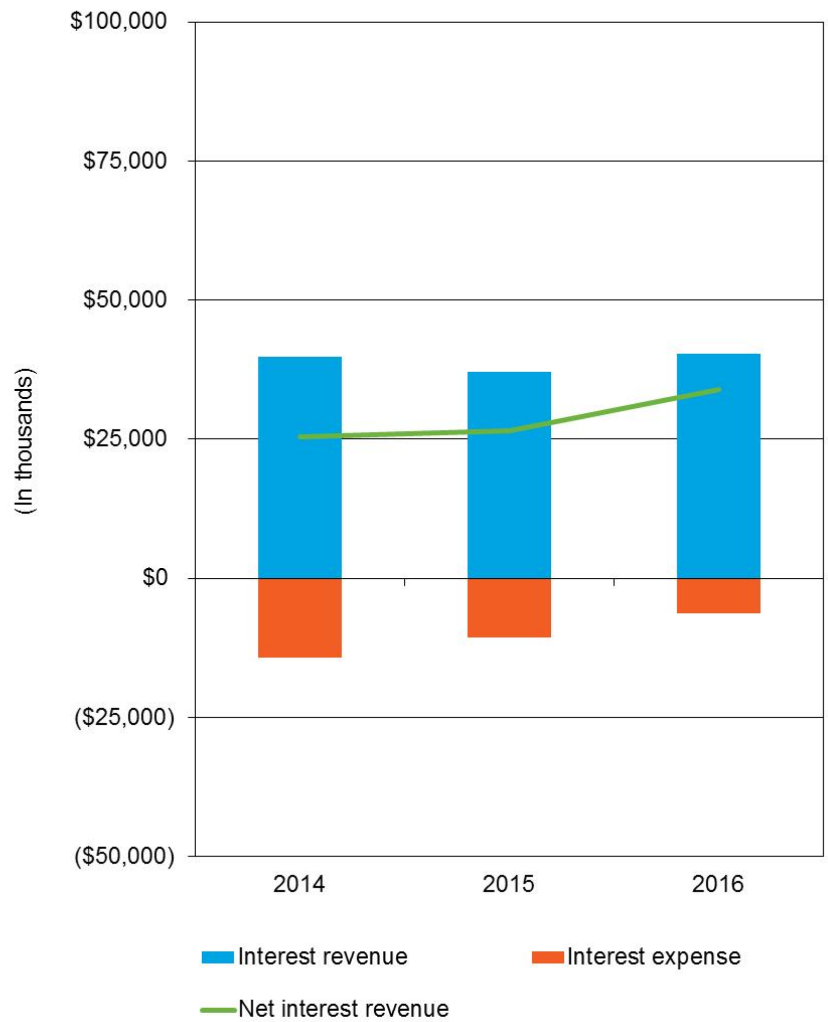


Operating income for the three months ended September 30, 2016, was $16.3 million, a 49.4% decrease from $32.2 million in 2015. Operating revenues were $161.7 million in 2016, an 8.2% increase from $149.5 million in 2015. Net interest revenue was $33.9 million in 2016, a 27.4% increase from $26.6 million in 2015. Noninterest revenue was $128.3 million in 2016, a 2.1% increase from $125.7 million in 2015. Operating expenses were $145.3 million in 2016, a 23.9% increase from $117.3 million in 2015.

A more detailed explanation of the results of operations follows.

Net Interest Revenue

Three months ended September 30



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

For the three months ended September 30, 2016, net interest revenue was $33.9 million, a 27.4% increase from $26.6 million in 2015. The increase in net interest revenue was mainly due to an increase in the unrealized gains on investments and a decrease in interest expense on student loan financings.

A more detailed explanation of the changes in net interest revenue follows.

Rate and Volume Analysis

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

As of September 30, 2016, the 91-day U.S. Treasury Bill rate was used to calculate special allowance for 3% of the student loan portfolio, the 3-month financial commercial paper rate was used to calculate special allowance for 14% of the student loan portfolio, and the 1-month LIBOR was used to calculate special allowance for 83% of the student loan portfolio.

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

(Dollars in thousands)	**2016 vs. 2015 Increase (decrease) attributable to change in**			2015 vs. 2014 Increase (decrease) attributable to change in		
For the three months ended September 30	**Increase (decrease)**	**Rate**	**Volume**	Increase (decrease)	Rate	Volume
Student loan interest revenue, net	**$ (2,346)**	**3,166**	**(5,512)**	$ (758)	1,122	(1,880)
Investment interest revenue:						
Investment income	**883**	**1,421**	**(538)**	(150)	(123)	(27)
Fair value adjustments	**4,575**	**3,052**	**1,523**	(1,699)	(1,717)	18
	3,112	**7,639**	**(4,527)**	(2,607)	(718)	(1,889)
Student loan financings interest expense, net	**(4,229)**	**(2,629)**	**(1,600)**	(3,713)	(2,694)	(1,019)
Other financings interest expense	**(20)**	**(5)**	**(15)**	(20)	(4)	(16)
	(4,249)	**(2,634)**	**(1,615)**	(3,733)	(2,698)	(1,035)
Net interest revenue	**$ 7,361**	**10,273**	**(2,912)**	$ 1,126	1,980	(854)

2016 vs. 2015 – Changes in Rate and Volume

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

For the three months ended September 30, 2016, the increase in the rate of our investment interest revenue was due to an increase in the returns earned on our investments at the Commonwealth of Pennsylvania Treasury. The increase in the volume of our investment interest revenue was due to us investing more funds in the Pennsylvania State Treasury.

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

Net Interest Margin

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

For the three months ended September 30,	**2016**	2015	2014
Student loan yields	**3.39%**	3.15%	3.12%
Consolidation loan rebate fees	**(0.84)**	(0.83)	(0.83)
Premium amortization	**(0.05)**	(0.03)	(0.07)
Student loan interest revenue, net	**2.50%**	2.29%	2.22%
Student loan financings interest expense, net	**(0.44)**	(0.63)	(0.80)
Net interest margin on student loans	**2.06%**	1.66%	1.42%

For the three months ended September 30, 2016, the increase in the student loan yields was due to an increase in the Treasury Bill rates associated with the variable rate FFELP loans in our student loan portfolio, and a decrease in the negative special allowance payments. The negative special allowance payments are a reduction to student loan interest revenue. The decrease in the rate of the premium amortization was due to the scheduled amortization.

For the three months ended September 30, 2016, the decrease in the student loan financings interest expense, net was mainly due to an increase in the amortization of the deferred gain on bond refundings, which is a reduction to student loan financings interest expense.

Noninterest Revenue

The following table displays the categories of noninterest revenue.

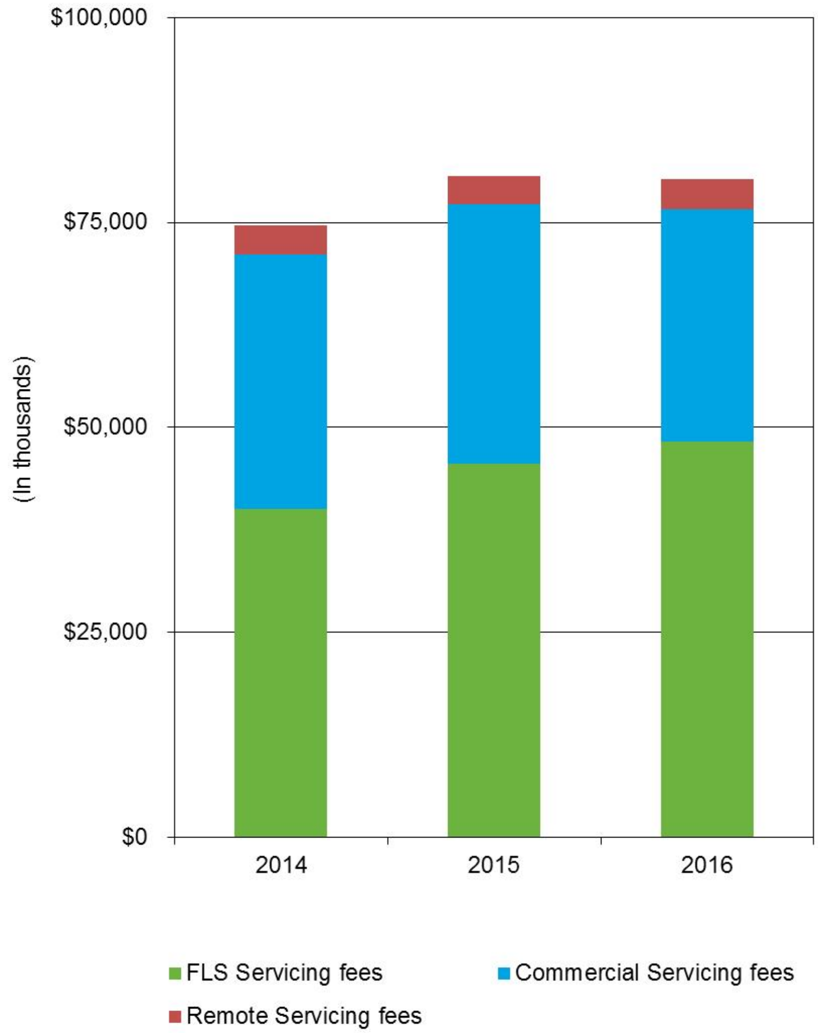
(Dollars in thousands)

For the three months ended September 30,	**2016**	2015	2014
Servicing fees	$ **80,297**	80,698	74,600
Retention of collections on defaulted loans, net	**42,025**	40,643	25,121
Federal fees	**4,478**	4,886	5,319
Other	**1,467**	(535)	64
Total noninterest revenue	$ **128,267**	125,692	105,104

For the three months ended September 30, 2016, total noninterest revenue was $128.3 million, a 2.1% increase from $125.7 million in 2015. In the sections that follow, we provide a more detailed explanation of the changes in total noninterest revenue.

Servicing Fees

Three months ended September 30



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

Total Servicing Fees

For the three months ended September 30, 2016, 2016, total servicing fees were $80.3 million, a 0.5% decrease from $80.7 million in 2015. For the three months ended September 30, 2016, the average third party loans serviced on our systems were $358.6 billion, an 11.7% increase from $321.1 billion in 2015.

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

FLS Servicing Fees

For the three months ended September 30, 2016, FLS Servicing fees were $48.3 million, a 5.9% increase from $45.6 million in 2015. For the three months ended September 30, 2016, the average FLS servicing portfolio of loans was $269.7 billion, a 16.4% increase from $231.8 billion in 2015. For the three months ended September 30, 2016, the average number of total unique borrowers in the FLS servicing portfolio was 7.6 million, a 2.7% increase from 7.4 million in 2015. For the three months ended September 30, 2016, the increase in FLS Servicing fees was due to an increase in the portfolio of loans serviced by us for ED and an increase in the average fee per borrower in the FLS servicing portfolio, as student loans mature and move into higher paying statuses.

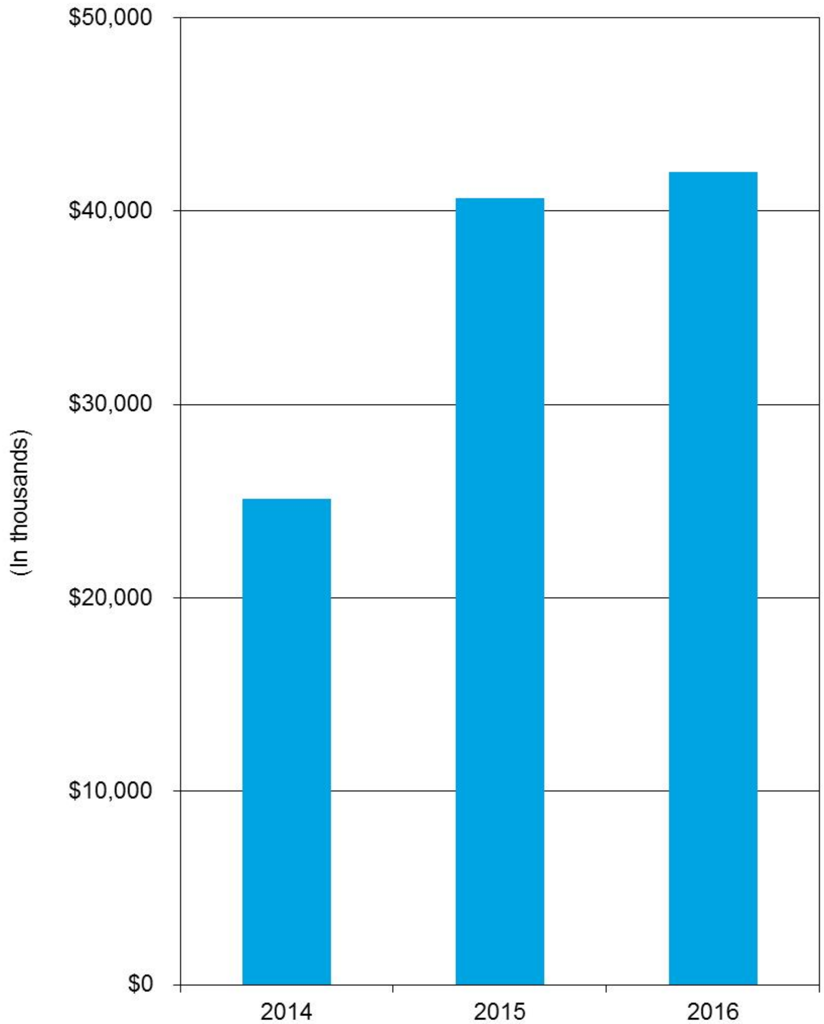
Commercial Servicing Fees

For the three months ended September 30, 2016, Commercial Servicing fees were $28.3 million, a 10.4% decrease from $31.6 million in 2015. For the three months ended September 30, 2016, the average Commercial Servicing portfolio of loans (excluding PHEAA owned loans) was $39.9 billion, a 10.1% decrease from $44.4 billion in 2015. For the three months ended September 30, 2016, the decrease in Commercial Servicing fees was primarily due to a decrease in the volume of our commercial servicing portfolio.

Remote Servicing Fees

For the three months ended September 30, 2016, Remote Servicing fees were $3.7 million, a 5.7% increase from $3.5 million in 2015. For the three months ended September 30, 2016, the average Remote Servicing portfolio of loans, excluding the NFP Servicers, was $14.1 billion, a 27.0% increase from $11.1 billion in 2015. For the three months ended September 30, 2016, the average portfolio of loans related to the NFP Servicers was $35.0 billion, a 3.6% increase from $33.8 billion for the same period ended 2015. For the three months ended September 30, 2016, the increase in Remote Servicing fees was primarily due to an increase in the volume of our Remote Servicers student loan servicing portfolio.

Retention of Collections on Defaulted Loans, net
Three months ended September 30



As a guarantor, we facilitate the guarantee of 97% - 100% of the borrower's outstanding loan balance depending on the disbursement date of the borrower's loan. The federal government reinsures the Federal Fund, which pays any claims on defaulted loan balances, based upon default rates of the portfolio of guaranteed loans and the disbursement date of the loan.

After a loan defaults and the Federal Fund pays a claim, we continue to try to collect on the loan and we earn revenue on the collection of defaulted loans. The Bipartisan Budget Act of 2013 (the "2013 Budget"), Section 501, reduced the amount that PHEAA and other guaranty agencies are permitted to retain on rehabilitated defaulted student loans. For rehabilitated loan sales on and after July 1, 2014, the 2013 Budget requires that we pay ED 100% of the principal balance of the loan at the time of sale (multiplied by the reinsurance percentage in effect when payment under the guaranty agreement was made with respect to the loan). In addition, we can retain collection costs and accrued interest. Collection costs charged to the borrower may not exceed 16% of the outstanding principal and interest at the time of the loan sale. Previously, guaranty agencies were required to repay ED 81.5% of the amount of the principal balance outstanding 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) and could retain the other 18.5% of principal. In addition, guaranty agencies retained collection costs and accrued interest, but the collection costs charged to the borrower could not exceed 18.5% of the principal balance and accrued interest at the time of loan sale.

For the three months ended September 30, 2016, the retention of collections on defaulted loans, net, was $42.0 million, a 3.4% increase from $40.6 million in 2015. For the three months ended September 30, 2016, total collections on defaulted loans was $271.0 billion, a 5.3% decrease from $286.1 million in 2015. For the three months ended September 30, 2016, the increase in the retention of collections on defaulted loans, net, was due to a decrease in the discounts offered to eligible lenders for purchasing rehabilitation loans, which was offset by a decrease in the collections on rehabilitation loans.

Collections on Rehabilitation Loans

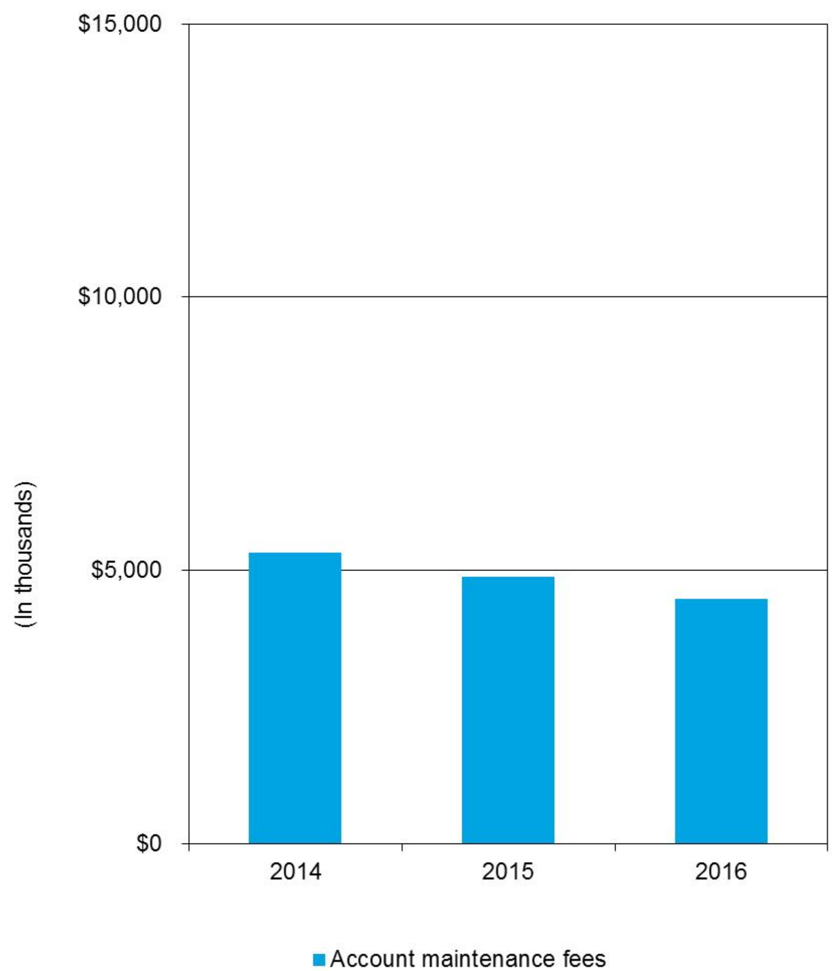
For the three months ended September 30, 2016, total rehabilitation collections were $186.4 million, a 3.4% decrease from $193.0 million in 2015. For the three months ended September 30, 2016, our share of collections on rehabilitation loans was $40.1 million, a 1.5% decrease from $40.7 million in 2015. For the three months ended September 30, 2016, the decrease in the collections on rehabilitation loans was due to a decrease in the volume of loans being rehabilitated.

Discounts on Rehabilitation Loans

For the three months ended September 30, 2016, the discount offered to eligible lenders for purchasing rehabilitation loans was $6.9 million, a 20.7% decrease from $8.7 million in 2015. For the three months ended September 30, 2016, the decrease in the discount offered to eligible lenders for purchasing rehabilitation loans was due to a decrease in the volume of rehabilitation loans sold at a discount.

Federal Fees

Three months ended September 30



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

For the three months ended September 30, 2016, federal fees were $4.5 million, an 8.2% decrease from $4.9 million in 2015. For the three months ended September 30, 2016, the average original principal balance of outstanding loans guaranteed was $28.7 billion, an 8.9% decrease from $31.5 billion in 2015. For the three months ended September 30, 2016, the decrease in federal fees was mainly due to the decrease in the average original principal balance of outstanding loans guaranteed.

Operating Expenses

The following tables display our major categories of operating expenses.

(Dollars in thousands)

For the three months ended September 30,		**2016**			2015			2014	
Personnel and benefits	$	**79,887**	**55.0%**	$	66,751	56.9%	$	55,517	49.6%
Professional services		**27,355**	**18.8%**		18,131	15.5%		11,877	10.6%
Information technology		**15,769**	**10.9%**		11,477	9.8%		11,128	9.9%
Mail services		**7,339**	**5.0%**		8,275	7.0%		8,821	7.9%
Depreciation		**3,822**	**2.6%**		3,315	2.8%		2,653	2.4%
Other		**11,164**	**7.7%**		9,398	8.0%		21,996	19.6%
Total operating expenses	$	**145,336**	**100.0%**	$	117,347	100.0%	$	111,992	100.0%

For the three months ended September 30, 2016, operating expenses were $145.3 million, a 23.9% increase from $117.3 million in 2015. In the sections that follow, we discuss changes in personnel and benefits, professional services, information technology and other expenses.

Personnel and Benefits

The following tables display personnel and benefits expenses:

(Dollars in thousands)

For the three months ended September 30,		**2016**			2015			2014	
Personnel and Benefits									
Compensation	$	**40,792**	**51.1%**	$	40,797	61.1%	$	35,732	64.4%
Pension expense		**21,586**	**27.0%**		8,737	13.1%		6,322	11.4%
Healthcare benefits for employees and retirees		**10,717**	**13.4%**		10,708	16.0%		7,799	14.0%
Independent contractor fees		**4,563**	**5.7%**		3,935	5.9%		3,628	6.5%
Employer's share of Social Security		**3,065**	**3.8%**		3,035	4.5%		2,678	4.8%
Capitalized software development costs		**(1,286)**	**(1.6%)**		(800)	(1.2%)		(912)	(1.6%)
Other		**450**	**0.6%**		339	0.6%		270	0.5%
Total personnel and benefits	$	**79,887**	**100.0%**	$	66,751	100.0%	$	55,517	100.0%

For the three months ended September 30, 2016, personnel and benefits costs were $79.9 million, a 19.6% increase from $66.8 million in 2015. A discussion on the changes in personnel and benefit costs follows.

Pension expense

For the three months ended September 30, 2016, pension expense was $21.6 million, a 148.3% increase from $8.7 million in 2015. For the three months ended September 30, 2016 and 2015, the increase in pension expense was due to a $1.8 million increase in our statutorily required contributions and an $11.1 million accrual of additional pension expense in anticipation of an increase in our proportionate share of collective pension expense.

Statutorily required contributions

For the three months ended September 30, 2016, our statutorily required contributions were $10.5 million, a 20.7% increase from $8.7 million in 2015. The increase in our statutorily required contributions was due to an increase in the employer contribution rates. For the three months ended September 30, 2016, the employer's contribution rate for the "A" Class of Service employees was 23.96%, a 20.5% increase from 19.89% in 2015; the employer's contribution rate for the "AA" Class of Service employees was 29.95%, a 20.5% increase from 24.86% in 2015; and the employer's contribution rate for the "A-3" and "A-4" Class of Service employees was 20.70%, a 20.5% increase from 17.18% in 2015. The majority of our employees fall under the AA, A-3 and A-4 Class of Service.

Professional Services

The following tables display professional services expenses:

(Dollars in thousands)

For the three months ended September 30,		**2016**			2015			2014	
Professional Services									
Collection agency fees	$	**9,820**	**35.9%**	$	10,982	60.6%	$	7,092	59.7%
Consulting fees		**9,442**	**34.5%**		1,663	9.2%		413	3.5%
Legal fees		**2,842**	**10.4%**		1,997	11.0%		2,535	21.3%
Default aversion outsourcing fees		**1,959**	**7.2%**		1,372	7.6%		913	7.7%
Data entry services		**1,927**	**7.0%**		1,309	7.2%		-	-
Audit fees		**608**	**2.2%**		419	2.3%		491	4.1%
Other professional services		**757**	**2.8%**		389	2.1%		433	3.7%
Total professional services	$	**27,355**	**100.0%**	$	18,131	100.0%	$	11,877	100.0%

For the three months ended September 30, 2016, professional services were $27.4 million, a 51.4% increase from $18.1 million in 2015. For the three months ended September 30, 2016, the increase in professional services was mainly due to an increase in consulting fees for information technology consultants.

Information Technology

The following tables display information technology expenses:

(Dollars in thousands)

For the three months ended September 30,		**2016**			2015			2014	
Information Technology									
PC software, licenses and rentals	**$**	**7,185**	**45.6%**	$	4,663	40.6%	$	5,146	46.2%
Equipment purchases, rentals and maintenance		**6,444**	**40.9%**		5,131	44.7%	$	4,418	39.7%
Other information technology		**2,140**	**13.5%**		1,683	14.7%		1,564	14.1%
Total information technology	**$**	**15,769**	**100.0%**	$	11,477	100.0%	$	11,128	100.0%

For the three months ended September 30, 2016, information technology was $15.8 million, a 37.4% increase from $11.5 million in 2015. For the three months ended September 30, 2016, the increase in information technology was mainly due to an increase in PC software, licenses and rentals, and equipment purchases and software maintenance.

For the three months ended September 30, 2016, PC software, licenses and rentals was $7.2 million, a 53.2% increase from $4.7 million in 2015, which was mainly due to an increase in license agreements and software purchases.

For the three months ended September 30, 2016, equipment purchases, rentals and maintenance was $6.4 million, a 25.5% increase from $5.1 million in 2015, which was mainly due to mainframe lease upgrades, storage equipment upgrades and the renewal of maintenance agreements.

Other

The following tables display other expenses:

(Dollars in thousands)

For the three months ended September 30,		**2016**			2015			2014	
Other expenses									
Bond issuance costs and bank fees	**$**	**5,642**	**50.5%**	$	2,414	25.7%	$	5,689	25.9%
Buildings and grounds		**2,289**	**20.5%**		1,529	16.3%		1,439	6.5%
Telephone		**1,821**	**16.3%**		1,908	20.3%		1,524	6.9%
Printing expense		**584**	**5.3%**		691	7.4%		758	3.5%
Third party guarantor expense		**439**	**3.9%**		498	5.3%		392	1.8%
Net realizable value adjustment in amounts due from the Federal Fund		**-**	**0.0%**		388	4.1%		10,675	48.5%
Other G&A		**389**	**3.5%**		1,970	20.9%		1,519	6.9%
Total other expenses	**$**	**11,164**	**100.0%**	$	9,398	100.0%	$	21,996	100.0%

For the three months ended September 30, 2016, other expenses were $11.2 million, a 19.1% increase from $9.4 million in 2015. For the three months ended September 30, 2016, the increase in other expenses was due to an increase in bond issuance costs and bank fees, an increase in buildings and grounds, which were offset by a decrease in Other G&A expenses.

A discussion on the changes in other expenses follows.

Bond issuance costs and bank fees

For the three months ended September 30, 2016, bond issuance costs and bank fees were $5.6 million, a 133.3% increase from $2.4 million in 2015. For the three months ended September 30, 2016, the increase in bond issuance costs and bank fees was mainly due an increase in bond issuance fees. For the three months ended September 30, 2016, bond issuance fees were $4.8 million an increase from $1.5 million in 2015. The increase in bond issuance fees was due to the PHEAA Student Loan Trust 2016-1 bond issuance on September 14, 2016 and the maintenance of our warehouse lines of credit.

Buildings and grounds

For the three months ended September 30, 2016, buildings and grounds expenses were $2.3 million, a 53.3% increase from $1.5 million in 2015. For the three months ended September 30, 2016, the increase in buildings and grounds expenses were due to building renovation expenses.

Other G&A

For the three months ended September 30, 2016, Other G&A expenses were $389 thousand, a decrease from $2.0 million in 2015. For the three months ended September 30, 2016, the decrease in Other G&A expenses were due to decreases in our servicer liability as a result of a decrease in curable loans associated with Title IV loans. As of September 30, 2016, there were $3.6 million of curable loans compared to $5.1 million as of June 30, 2016, which was a decrease of $1.5 million or 29.4%. As of September 30, 2015, there were $4.6 million of curable loans compared to $4.8 million as of June 30, 2015, which was a decrease of $173 thousand or 3.6%.

Changes in Net Position

The following table shows the changes in net position:

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015	2014
Income before grants and financial aid	$	**16,363**	32,209	16,013
Commonwealth of Pennsylvania grants		**168,067**	54	199,728
Federal grants		**38**	-	17
Grants and other financial aid, net of refunds		**(152,929)**	(12,127)	(184,934)
Total grants and financial aid, net of refunds		**15,176**	(12,073)	14,811
Changes in net position	$	**31,539**	20,136	30,824

Commonwealth of Pennsylvania Grants

For the three months ended September 30, 2016, Commonwealth of Pennsylvania grants were $168.1 million, an increase from $54 thousand in 2015. For the three months ended September 30, 2016, the increase in the Commonwealth of Pennsylvania grants was due to PHEAA receiving allocated funds from the Commonwealth for fiscal year 2016-17. For the three months ended September 30, 2015, the PHEAA did not receive allocated grant funds from the Commonwealth, because the Commonwealth did not finalize their fiscal year 2015-16 budget until March 28, 2016.

Grants and Other Financial Aid Activity, net

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

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015	2014
Pennsylvania State Grant Program, net of refunds	$	**136,876**	7,907	176,625
Pennsylvania National Guard Education Assistance Program, net of refunds		**5,686**	(1,150)	4,082
Institutional Assistance Grant Program, net of refunds		**3,263**	2,365	2,637
Higher Education for the Disadvantaged Program, net of refunds		**1,949**	467	712
Pennsylvania Distance Education Program, net of refunds		**1,522**	937	-
Pennsylvania Targeted Industry Cluster Certificate Scholarship Program, net of refunds		**1,377**	738	(113)
Matching Funds Grant Program, net of refunds		**719**	712	825
Other Programs, net of refunds		**1,537**	151	166
Total grants and other financial aid, net	$	**152,929**	12,127	184,934

For the three months ended September 30, 2016, grants and other financial aid, net, were $152.9 million, an increase from $12.1 million during 2015. For the three months ended September 30, 2016, the increase in grants and other financial aid, net, was due to the disbursement of allocated funds from the Commonwealth for fiscal year 2016-17. For the three months ended September 30, 2015, we did not disburse allocated funds from the Commonwealth, because the Commonwealth's budget for fiscal year 2015-16 was not finalized until March 28, 2016.

Student Loan Receivables, net

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016
FFEL student loans:			
Consolidation	**$**	**4,544,622**	4,705,793
Stafford		**1,018,846**	1,074,457
PLUS		**97,340**	104,978
Supplemental Loans for Students (SLS)		**944**	987
Total FFEL student loans		**5,661,752**	5,886,215
HEAL		**25,679**	27,974
Private		**23,372**	28,789
Unamortized premium on student loan purchases		**7,455**	8,203
Unamortized discount on student loan purchases		**(10,968)**	(11,913)
		5,707,290	5,939,268
Allowance for loan losses		**(9,612)**	(21,229)
Student loan receivables, net	**$**	**5,697,678**	5,918,039

As of September 30, 2016, student loan receivables, net, were $5.7 billion, a 3.4% decrease from $5.9 billion in June 2016. As of September 30, 2016, the decrease in student loan receivables, net, was mainly due to borrower payments.

Delinquencies have the potential to adversely affect earnings through increased collection costs and charge-offs. The September 30, 2016 table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $6.3 million of student loans categorized as non-performing, $4.5 million of student loans categorized as uninsured and $105 thousand of student loans with credit balances.

(Dollars in thousands)

As of September 30, 2016	FFEL		Non-FFEL		Total	
Loans in-school/in-grace	$ 7,328		$ 62		$ 7,390	
Loans in deferment and forbearance:						
Deferment	393,725		1,229		394,954	
Forbearance	535,961		558		536,519	
Total loans in-school/in-grace, and deferment and forbearance	$ 937,014		$ 1,849		$ 938,863	
Loans in repayment:						
Current	$ 4,139,501	87.7%	$ 44,777	92.1%	$ 4,184,278	87.7%
31 – 60 days	170,821	3.6%	816	1.7%	171,637	3.6%
61 – 90 days	92,544	2.0%	287	0.6%	92,831	1.9%
91 – 120 days	77,835	1.6%	182	0.4%	78,017	1.6%
121 – 180 days	103,283	2.2%	309	0.6%	103,592	2.2%
181 – 270 days	88,320	1.9%	53	0.1%	88,373	1.9%
271 days or greater	32,369	0.7%	975	2.0%	33,344	0.7%
Claims filed not paid	16,345	0.3%	1,197	2.5%	17,542	0.4%
Total loans in repayment	$ 4,721,018	100.0%	$ 48,596	100.0%	$ 4,769,614	100.0%

The June 30, 2016 table below presents our student loan delinquency trends on FFEL and non-FFEL student loans, but does not include $6.5 million of student loans categorized as non-performing, $8.4 million of student loans categorized as uninsured and $72 thousand of student loans with credit balances.

(Dollars in thousands)

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

Allowance for Loan Losses

FFEL Program Loans

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

- FFEL program loans - The allowance for loan losses represents our estimate of the costs related to the risk sharing on the FFEL program loans and it is a weighted average calculation based upon the following guarantee rates:

    - 100% of the unpaid principal balance of each loan disbursed before October 1, 1993;
    - Not more than 98% of the unpaid principal balance of each loan disbursed on or after October 1, 1993 and before July 1, 2006; and
    - Not more than 97% of the unpaid principal balance of each loan disbursed on or after July 1, 2006 and before July 1, 2010. Student loans were no longer originated under the FFEL program on or after July 1, 2010.

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

This allowance along with the allowance for loan losses-other program loans (Non-FFEL) are included in the section titled "Allowance for loan losses" in **Note 5 – Student Loans Receivable, net**.

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

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Balance at beginning of period	$	**16,599**	15,100	15,100	14,557
Provision for losses		**276**	7,882	2,805	6,536
Charge-offs/Write-offs		**(7,562)**	(6,383)	(1,597)	(5,993)
Balance at end of period	$	**9,313**	16,599	16,308	15,100
Ending balance of FFEL student loans	$	**5,661,752**	5,886,215	6,625,081	6,865,200
Allowance as a percentage of ending balance of student loans		**0.16%**	0.28%	0.25%	0.22%

As of September 30, 2016, we believe the allowance for loan losses is adequate to cover the inherent losses on our FFEL student loan portfolio.

For the three months ended September 30, 2016, the decrease in the provision for loan losses was due to the write-off of non-performing loans.

Other Program Loans (Non-FFEL)

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

- Private loans – We record a provision for loan losses on private loans when the student loan payment status is no longer current (payments are more than 120 days past due) and/or non-performing.

    - The student loans formerly guaranteed by The Education Resource Institute, Inc. (TERI) are included with the private loans. We record a provision on 100% of the TERI student loan balances that have a payment delinquency status of 121 days and greater, and those loans classified as "claims filed but not paid".

    - The student loans associated with Pennsylvania nursing schools and the Health Education Assistance Loan ("HEAL") supplemental student loans are included with the private loans. The Pennsylvania nursing school student loans are self- insured by us and the HEAL supplemental student loans are private student loans without a guarantee. We record a provision for loan losses for these programs when the student loans are greater than 120 days delinquent and student loans that have a claim filed or are non-performing.

These allowances along with allowance for losses on FFEL program loans are included in the section titled "Allowance for loan losses" in **Note 5 – Student Loans Receivable, net**.

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Balance at beginning of period	$	**4,630**	5,771	5,771	5,155
Provision for losses		**246**	(1,141)	(79)	616
Charge-offs/Write-offs		**(4,577)**	-	-	-
Balance at end of period	$	**299**	4,630	5,692	5,771
Ending balance of non-FFEL student loans	$	**49,051**	56,763	68,637	72,045
Allowance as a percentage of ending balance of student loans		**0.61%**	8.16%	8.29%	8.01%

As of September 30, 2016, we believe the allowance for loan losses is adequate to cover the inherent losses on our non-FFEL student loan portfolio.

For the three months ended September 30, 2016, the decrease in the provision for loan losses was due to the write-off of non-performing loans.

Debt Activity and Capital Assets

Debt Activity

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Deferred outflow of resources:					
Deferred loss on bond refundings	$	**1,120**	1,299	1,835	2,013
Current liabilities:					
Student loan financings	$	**491,342**	938,213	866,493	903,779
Other financings		**3,895**	3,895	3,745	3,745
Long-term liabilities:					
Student loan financings, net	$	**5,095,794**	4,751,841	5,614,262	5,852,233
Other financings, net		**30,578**	30,734	35,115	35,290
Deferred inflow of resources:					
Deferred gain on bond refundings	$	**120,084**	134,067	163,066	168,779

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

As of September 30, 2016, our outstanding debt, excluding our blended component units, the deferred gain and loss on bond refundings, premiums and discounts on bonds, amounted to $1.0 billion, which was below the 20% threshold mentioned above. The blended component units are excluded from this threshold, because their debt was not issued by PHEAA. As of September 30, 2016, the outstanding debt of our blended component units was $4.6 billion, which was related to the student loan trusts. See **Note 8 – Blended Component Units** for more details on the student loan trusts.

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

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015	2014
Capital market activity				
Proceeds from issuing student loan floating rate notes	$	**543,671**	-	645,101
Repayment of student loan floating rate notes		**(189,179)**	(225,779)	(189,731)
Repayment of student loan auction rate security bonds		**(11,600)**	(12,750)	(31,275)
Student loan financing activity				
Proceeds from student loan financings	$	**-**	-	73,000
Repayment of student loan financings		**(446,872)**	(37,286)	(304,209)

2016 Debt Activity

Capital Market Activity & Student Loan Financing Activity

For the three months ended September 30, 2016, the $543.7 million of student loan floating rate note proceeds were due to the PHEAA Student Loan Trust 2016-1 bond issuance on September 14, 2016.

For the three months ended September 30, 2016, the $189.2 million of student loan floating rate notes repayments and the $11.6 million of student loan auction rate security bond repayments were due to scheduled payments.

For the three months ended September 30, 2016, the $446.9 million of student loan financings repayments were due to the pay down of the warehouse lines of credit as a result of the PHEAA Student Loan Trust 2016-1 bond issuance mentioned above and scheduled debt payments.

See **Note 6 – Notes and Bonds Payable and Other Financings** for more details on the above debt activity.

Capital Assets

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Land	$	**8,038**	8,038	8,038	8,038
Buildings and improvements, net		**32,944**	33,082	33,530	33,371
IT equipment, net		**12,509**	9,824	9,172	8,663
Purchased software, net		**12,382**	11,410	8,113	8,806
Software development, net		**9,837**	9,617	9,129	9,305
Other, net		**7,470**	7,116	7,648	7,776
	$	**83,180**	79,087	75,630	75,959

As of September 30, 2016, capital assets, net of accumulated depreciation and amortization, were $83.2 million, a 5.2% increase from $79.1 million as of June 30, 2016. The increase in capital assets, net of accumulated depreciation and amortization, was mainly due to the purchase of IT equipment and purchased software.

Net Position

The following table shows our restricted and unrestricted net position.

(Dollars in thousands)		**September 30, 2016**	June 30, 2016	September 30, 2015	June 30, 2015
Net investment in capital assets	$	**83,180**	79,087	75,630	75,959
Restricted for debt service		**301,030**	310,324	276,176	263,381
Restricted for financial aid grant programs		**70,269**	52,079	49,899	61,478
Unrestricted		**328,771**	310,221	422,451	403,202
	$	**783,250**	751,711	824,156	804,020

Net investment in capital assets

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

As of September 30, 2016, the net investment in capital assets was $83.2 million, a 5.2% increase from $79.1 million as of June 30, 2016. The increase in net investment in capital assets was mainly due to the purchase of IT equipment and software.

Restricted for debt service

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

As of September 30, 2016, we had net position restricted for debt service of $301.0 million, a 3.0% decrease from $310.3 million as of June 30, 2016. The decrease in net position restricted for debt service was due to $16.5 million of operating income restricted for debt service, which was offset by $25.8 million of transfers to unrestricted net position. See **Note 7 - Segment Information** for more details.

Restricted for financial aid grant programs

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

As of September 30, 2016, we had net position restricted for financial aid grant programs of $70.3 million, a 34.9% increase from $52.1 million as of June 30, 2016. The increase in net position restricted for financial aid grant programs was mainly due to $100 thousand of operating income restricted for financial aid grant programs, $168.1 million of grant funding, which was offset by $150.0 million of grant disbursements, net of refunds.

Unrestricted

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

As of September 30, 2016, we had unrestricted net position of $328.8 million, a 6.0% increase from $310.2 million as of June 30, 2016. The increase in unrestricted net position was due to $25.8 million of funds transferred from net position restricted for debt service, which was offset by unrestricted operating loss of $201 thousand, $2.9 million of net grant disbursements and $4.1 million of funds transferred to net investment in capital assets.

Federal Student Loan Reserve Fund (Federal Fund)

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

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

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015	2014
Additions				
Collections on defaulted loans	$	**234,078**	246,888	156,221
Reinsurance from the U.S. Department of Education		**190,163**	263,489	325,754
Transfers of guarantee reserves		**-**	-	(7)
Net appreciation in fair value of investments		**41**	11	4
Total additions		**424,282**	510,388	481,972
Deductions				
Purchases of defaulted loans from lenders		**188,964**	272,579	337,907
Reimbursement to U.S. Department of Education for federal share of defaulted loans collections		**176,992**	187,925	125,461
Reimbursement to PHEAA for our retention of defaulted loans collections		**48,904**	49,370	(15,379)
Default aversion fees, net		**2,348**	2,443	2,828
Total deductions		**417,208**	512,317	450,817
Net increase (decrease)		**7,074**	(1,929)	31,155
Net liabilities, beginning of period		**(172,499)**	(186,818)	(201,841)
Net liabilities, end of period	$	**(165,425)**	(188,747)	(170,686)

For the three months ended September 30, 2016, collections on defaulted loans were $234.1 million, a 5.2% decrease from $246.9 million in 2015. For the three months ended September 30, 2016, purchases of defaulted loans were $189.0 million, a 30.7% decrease from $272.6 million in 2015.

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

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

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

(Dollars in thousands)		**As of September 30, 2016**	As of September 30, 2015
Generally accepted accounting principles – net position	$	**(165,425)**	(188,747)
Gain contingency – default aversion fee rebate payable from PHEAA to the Federal Fund		**6,108**	3,349
Gain contingency – collections complement on future default collections		**73,182**	109,072
Default aversion fees payable to PHEAA, but not transferred from the Federal Fund to PHEAA		**191,892**	186,035
Federal Fund balance	$	**105,757**	109,709
Original principal outstanding	$	**28,345,419**	31,175,068
Federal reserve ratio		**0.37%**	0.35%

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

Contacting Us

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Phone – (717) 720-7890
Fax – (717) 720-3923
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November 17, 2016

(Dollars in thousands)

		For the three months ended September 30, 2016	2015
Operating revenues and expenses			
Interest revenue			
Student loans, net	$	**36,346**	38,692
Investments		**3,939**	(1,519)
Total interest revenue		**40,285**	37,173
Interest expense			
Student loan financings, net		**6,243**	10,472
Other financings		**115**	135
Total interest expense		**6,358**	10,607
Net interest revenue		**33,927**	26,566
Provision for loan losses		**(522)**	(2,726)
Net interest revenue after provision for loan losses		**33,405**	23,840
Noninterest revenue			
Servicing fees		**80,297**	80,698
Retention of collections on defaulted loans, net		**42,025**	40,643
Federal fees		**4,478**	4,886
Other		**1,467**	(535)
Total noninterest revenue		**128,267**	125,692
Operating revenues		**161,672**	149,532
Operating expenses			
Personnel and benefits		**79,887**	66,751
Professional services		**27,355**	18,131
Information technology		**15,769**	11,477
Mail services		**7,339**	8,275
Depreciation		**3,822**	3,315
Other		**11,164**	9,398
Total operating expenses		**145,336**	117,347
Operating income		**16,336**	32,185
Non-operating losses			
Loss on sale of capital assets		**27**	24
Income before grants and financial aid		**16,363**	32,209
Grants and financial aid			
Commonwealth of Pennsylvania grants		**168,067**	54
Federal grants		**38**	-
Grants and other financial aid, net of refunds		**(152,929)**	(12,127)
Total grants and financial aid, net		**15,176**	(12,073)
Changes in net position		**31,539**	20,136
Net position, beginning of period		**751,711**	804,020
Net position, end of period	$	**783,250**	824,156

See accompanying notes to financial statements.

(Dollars in thousands)

		Unaudited September 30, 2016	June 30, 2016
Current assets:			
Cash and cash equivalents	$	**74,303**	72,713
Restricted cash and cash equivalents		**304,265**	223,188
Restricted cash and cash equivalents – due to customers		**92,813**	72,256
Investments		**545,497**	531,706
Restricted investments		**69,797**	50,661
Student loans receivable		**808,975**	962,917
Interest income receivable		**73,669**	77,964
Due from Federal Student Loan Reserve Fund, net		**29,431**	37,074
Federal Student Loan Reserve Fund assets held for U.S. Dept. of Ed., net		**54,964**	55,533
Other assets		**81,044**	66,586
Total current assets		**2,134,758**	2,150,598
Long-term assets:			
Student loans receivable, net		**4,888,703**	4,955,122
Capital assets, net		**83,180**	79,087
Total long-term assets		**4,971,883**	5,034,209
Total assets		**7,106,641**	7,184,807
Deferred outflow of resources:			
Deferred outflows of resources related to pensions		**126,827**	126,826
Deferred loss on bond refundings		**1,120**	1,299
Total deferred outflow of resources		**127,947**	128,125
Current liabilities:			
Accounts payable and accrued expenses		**179,769**	183,456
Student loan financings		**491,341**	938,213
Amounts related to the Federal Student Loan Reserve Fund		**54,964**	55,533
Other financings		**3,895**	3,895
Total current liabilities		**729,970**	1,181,097
Long-term liabilities:			
Student loan financings, net		**5,095,795**	4,751,841
Net pension liability		**451,784**	440,673
Other financings, net		**30,578**	30,734
Accrued expenses		**21,925**	21,582
Total long-term liabilities		**5,600,081**	5,244,830
Total liabilities		**6,330,051**	6,425,927
Deferred inflow of resources:			
Deferred gain on bond refundings		**120,084**	134,067
Deferred inflows of resources related to pensions		**872**	872
Deferred gain on sales leaseback		**331**	355
Total deferred inflow of resources		**121,287**	135,294
Net position:			
Net investment in capital assets		**83,180**	79,087
Restricted for debt service		**301,030**	310,324
Restricted for financial aid grant programs		**70,269**	52,079
Unrestricted		**328,771**	310,221
Total net position	$	**783,250**	751,711

See accompanying notes to financial statements.

(Dollars in thousands)

		For the three months ended September 30,	
		2016	2015
Cash flows from operating activities			
Interest received on student loans	$	**23,944**	16,372
Principal received on student loans		**210,466**	292,366
Student loan purchases		**(193,184)**	(201,223)
Student loan sales, including net gains and losses		**208,685**	181,024
Servicing fees		**84,532**	82,998
Retention of collections on defaulted loans		**49,799**	55,964
Federal fees		**4,578**	4,995
Default aversion fee rebates		**10**	143
Other		**66**	81
Payment of operating expenses		**(157,415)**	(131,861)
Net cash provided by operating activities		**231,481**	300,859
Cash flows from noncapital financing activities			
Proceeds from the issuance of noncapital debt		**543,671**	-
Principal paid on noncapital debt		**(647,651)**	(275,815)
Interest paid on noncapital debt		**(18,328)**	(15,966)
Bond issuance costs		**(4,817)**	(1,456)
Commonwealth of Pennsylvania grants received		**168,067**	54
Federal grants received		**38**	-
Grants and financial aid paid		**(152,929)**	(12,127)
Net cash used for noncapital financing activities		**(111,949)**	(305,310)
Cash flows from capital and related financing activities			
Purchases of capital assets and development of software, net of disposals		**(7,913)**	(2,986)
Net cash used for capital and related financing activities		**(7,913)**	(2,986)
Cash flows from investing activities			
Proceeds from sales and maturities of investments		**241,766**	112,628
Purchases of investments		**(272,466)**	(129,539)
Interest received on investments		**1,748**	827
Net cash used for investing activities		**(28,952)**	(16,084)
Net change in cash and cash equivalents (including restricted cash)		**82,667**	(23,521)
Cash and cash equivalents (including restricted cash), beginning of period		**295,901**	327,989
Cash and cash equivalents (including restricted cash), end of period	$	**378,568**	304,468

(continued)

(Dollars in thousands)

		For the three months ended September 30, 2016	2015
Reconciliation of operating income to net cash provided by operating activities			
Operating income	$	**16,336**	32,185
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation		**3,822**	3,315
Interest paid on noncapital debt		**18,328**	15,966
Investment interest		**(3,939)**	1,519
Bond issuance costs		**4,817**	1,456
Pension expense valuation adjustment		**11,111**	-
Amortization of premium on loan purchases		**749**	476
Amortization of deferred gain on bond refunding		**(13,804)**	(5,535)
Amortization of deferred discount on bonds payable		**1,062**	559
Amortization of deferred premium on other financings		**(156)**	(176)
Changes in assets and liabilities:			
Decrease in interest income receivable		**4,259**	5,776
Decrease in student loans receivable		**219,612**	246,211
Decrease in amounts due from Federal Student Loan Reserve Fund		**7,643**	15,320
Increase in other assets		**(14,458)**	(13,878)
Decrease in accounts payable and accrued expenses		**(23,901)**	(2,335)
Total adjustments		**215,145**	268,674
Net cash provided by operating activities	$	**231,481**	300,859

See accompanying notes to financial statements.

Note 1 – About PHEAA

Organization

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

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

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

Blended Component Units

PHEAA Student Loan Foundation, Inc.

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

PHEAA Student Loan Trust I

On January 15, 2003, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust I (the "Trust"), a statutory trust. The Trust was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and related assets and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date.

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

PHEAA Student Loan Trust 2011-1

On April 7, 2011, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2011-1 (“2011-1 Trust”), a statutory trust. The 2011-1 Trust was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and related assets, and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the 2011-1 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2011-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2011-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2011-1 Trust with the Foundation. In addition, the 2011-1 Trust is a blended component unit of the Foundation, because the 2011-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2011-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2012-1

On October 11, 2012, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2012-1 (“2012-1 Trust”), a statutory trust. The 2012-1 Trust was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and related assets, and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the 2012-1 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2012-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2012-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2012-1 Trust with the Foundation. In addition, the 2012-1 Trust is a blended component unit of the Foundation, because the 2012-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2012-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2013-1

On March 18, 2013, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2013-1 (“2013-1 Trust”), a statutory trust. The 2013-1 Trust was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and related assets, and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the 2013-1 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2013-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2013-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2013-1 Trust with the Foundation. In addition, the 2013-1 Trust is a blended component unit of the Foundation, because the 2013-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2013-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2013-2

On March 18, 2013, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2013-2 (“2013-2 Trust”), a statutory trust. The 2013-2 Trust was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and related assets, and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the 2013-2 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2013-2 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2013-2 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2013-2 Trust with the Foundation. In addition, the 2013-2 Trust is a blended component unit of the Foundation, because the 2013-2 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2013-2 Trust are consolidated with the financial results of the Foundation.

PHEAA Warehouse Facility Trust 2013-1

On April 8, 2013, the Foundation entered into a trust agreement creating the PHEAA Warehouse Facility Trust 2013-1 (“Warehouse Trust 2013-1”) as a statutory trust. The Warehouse Trust 2013-1 was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and student loan related assets and to acquire student loans from the Foundation and issue a note secured by a pledge of assets. The assets of the Warehouse Trust 2013-1 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 Warehouse Trust 2013-1 is legally separate and fiscally independent from the Foundation. However, we determined that the Warehouse Trust 2013-1 should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the Warehouse Trust 2013-1with the Foundation. In addition, the Warehouse Trust 2013-1 is a blended component unit of the Foundation, because the Warehouse Trust 2013-1 provides services entirely to the Foundation. As a blended component unit, the financial results of the Warehouse Trust 2013-1 are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2013-3

On October 3, 2013, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2013-3 (“2013-3 Trust”), a statutory trust. The 2013-3 Trust was formed under the laws of the State of Delaware and its principal purpose is to securitize student loans and related assets, and to acquire student loans from the Foundation and issue promissory notes secured by a pledge of such assets. The assets of the 2013-3 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2013-3 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2013-3 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2013-3 Trust with the Foundation. In addition, the 2013-3 Trust is a blended component unit of the Foundation, because the 2013-3 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2013-3 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2014-1

On October 3, 2013, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2013-4, a statutory trust under the laws of the State of Delaware. On January 29, 2014, the Foundation and the owner trustee entered into a "First Amendment to the Trust Agreement" ("First Amendment") to modify the legal name of the PHEAA Student Loan Trust 2013-4 to the PHEAA Student Loan Trust 2014-1 ("2014-1 Trust"). On the same date, upon execution of the First Amendment, a "Second Amended and Restated Certificate of Trust" was filed to register the new legal name of the 2014-1 Trust with the Delaware Secretary of State.

The principal purpose of the 2014-1 Trust 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 2014-1 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2014-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2014-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2014-1 Trust with the Foundation. In addition, the 2014-1 Trust is a blended component unit of the Foundation, because the 2014-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2014-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2014-2

On April 16, 2014, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2014-2 ("2014-2 Trust"), a statutory trust under the laws of the State of Delaware. The principal purpose of the 2014-2 Trust 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 2014-2 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2014-2 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2014-2 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2014-2 Trust with the Foundation. In addition, the 2014-2 Trust is a blended component unit of the Foundation, because the 2014-2 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2014-2 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2014-3

On August 8, 2014, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2014-3 ("2014-3 Trust"), a statutory trust under the laws of the State of Delaware. The principal purpose of the 2014-3 Trust 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 2014-3 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2014-3 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2014-3 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2014-3 Trust with the Foundation. In addition, the 2014-3 Trust is a blended component unit of the Foundation, because the 2014-3 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2014-3 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2015-1

On January 15, 2015, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2015-1 (“2015-1 Trust”), a statutory trust under the laws of the State of Delaware. The principal purpose of the 2015-1 Trust 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 2015-1 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2015-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2015-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2015-1 Trust with the Foundation. In addition, the 2015-1 Trust is a blended component unit of the Foundation, because the 2015-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2015-1 Trust are consolidated with the financial results of the Foundation.

PHEAA Student Loan Trust 2016-1

On May 7, 2015, the Foundation entered into a trust agreement with a financial institution, which created the PHEAA Student Loan Trust 2015-2, a statutory trust under the laws of the State of Delaware. On August 5, 2016, an Amended and Restated Certificate of Trust was filed with the Delaware Secretary to modify the legal name of the PHEAA Student Loan Trust 2015-2 to the PHEAA Student Loan Trust 2016-1 (“2016-1”). The principal purpose of the 2016-1 Trust 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 2016-1 Trust generally include student loans, collections and other payments on the student loans, and funds in trust accounts held by an indenture trustee. The student loans are pledged to an indenture trustee under an indenture agreement, and the student loans provide collateral for a bond issuance. The bonds are payable solely from and secured solely by the trust estate. Principal payments are generally funded from available funds and the principal payments are made to noteholders pro rata on each distribution date in an amount generally equal to the principal distribution amount for that distribution date. The 2016-1 Trust is legally separate and fiscally independent from the Foundation. However, we determined that the 2016-1 Trust should be a component unit in order to keep our financial reports from being misleading due to the material relationship of the 2016-1 Trust with the Foundation. In addition, the 2016-1 Trust is a blended component unit of the Foundation, because the 2016-1 Trust provides services entirely to the Foundation. As a blended component unit, the financial results of the 2016-1 Trust are consolidated with the financial results of the Foundation.

The Pennsylvania Higher Education Foundation, Inc.

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

PHEF's governing board, and PHEAA has the ability to impose its will on PHEF. PHEF is considered a blended component unit, because PHEF no longer provided services to outside third parties in the form of grants and scholarships used to promote nursing education, but rather provided services entirely to us. As a blended component unit, the financial results of PHEF are consolidated with the financial results of PHEAA.

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

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Accounting

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

Use of Estimates

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

Cash Equivalents

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

Restricted Cash and Investments

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

Investments

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

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

Student Loans Receivable, net

We report student loans in the Statements of Net Position at their unpaid principal balances net of an allowance for inherent losses within our student loan portfolio. Allowances for potential losses on our student loans can result from deficient servicing, risk sharing on defaults and uninsured loans. These allowances are based upon our ongoing evaluation of the loan portfolios, past and anticipated loss experience and the amount and quality of the loans. We maintain the allowances at a level that we believe is adequate to absorb estimated incurred losses, but our evaluation is inherently subjective and the required allowances may significantly change in the future. We report expenses related to risk sharing on defaults in the provision for loan losses, and we include the expenses related to servicing deficiencies in “Other” operating expenses.

Capital Assets, net

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

We capitalize purchased computer software if the per unit costs, based on per license fee, is $10,000 or more. We capitalize improvements or additions to existing software that constitute a capital outlay or increase the value or life of the asset by 25% of the original cost or life as a betterment and we record it as an addition of value to the existing asset. We calculate amortization based on the straight-line method over the estimated useful life of the purchased software.

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

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

- Buildings and improvements 7 – 40 years
- Furniture, furnishings and equipment 5 – 10 years
- Software (purchased and development) 3 – 5 years

Deferred Gain (Loss) on Bond Refundings

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

Compensated Absences

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

Revenue Recognition

Student loan interest revenue, net

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

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

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

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

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

Servicing fees

We earn servicing fee revenue by servicing student loans owned by third parties. We recognize servicing fees when we provide the contractual services and we record the unbilled amounts as accounts receivable. We categorize revenue earned from loans owned by ED as “FLS Servicing”; whereas, we categorize revenue earned from loans owned by financial institutions and secondary markets as “Commercial Servicing”. Our Remote Servicing line of business provides our system to guarantors and other servicers to use.

Retention of Collections on Defaulted Loans

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

Federal Fees

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

Operating Revenues and Expenses

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

Advertising

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

Commonwealth of Pennsylvania and Federal Grant Revenues

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

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

Elimination of Intra-Entity Activity

The Trust I, 2011-1 Trust, 2012-1 Trust, 2013-1 Trust, 2013-2 Trust, 2013-3 Trust, 2014-1 Trust, 2014-2 Trust, 2014-3 Trust, 2015-1 Trust, 2016-1 Trust and Warehouse Trust 2013-1 are blended component units of the Foundation, and the Foundation is a blended component unit of PHEAA. In addition, PHEF is a blended component unit of PHEAA. We consider the resource flows between PHEAA and the blended component units as intra-entity, because PHEAA is the administrator and servicer for the blended component units. We eliminate the intra-entity activity in the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows.

Note 3 – Recently Issued GASB Pronouncements

During 2015, the GASB issued Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (“GASB 75”). This Statement replaces the requirements of GASB Statements No. 45 - *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57 - *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. This Statement is effective for fiscal years beginning after June 15, 2017, and earlier application is encouraged. Currently, we are evaluating the impact of this Statement on our financial statements.

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

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

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016
Assets			
Cash	$	**31,408**	38,301
Receivable from the U.S. Department of Education		**26,971**	36,935
Other receivables		**81**	219
Total assets		**58,460**	75,455
Liabilities			
Accounts payable and accrued expenses		**3,496**	1,997
Payable to USDE		**-**	17,925
Amounts payable to PHEAA		**220,389**	228,032
Total liabilities		**223,885**	247,954
Net liabilities	$	**(165,425)**	(172,499)

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

As of September 30, 2016, we have managed the cash flow of the Federal Fund in a manner to assure our customers that sufficient funds are available to continue to pay default claims by not transferring default aversion fees that are due to us. In addition to paying default claims, we pay our share of retention on defaulted loan collections from the Federal Fund.

As of September 30, 2016 and June 30, 2016, we reported $55.0 million and $55.5 million, respectively, in the line item “Federal Student Loan Reserve Fund assets held for the U.S. Department of Education, net” in the Statements of Net Position, which is the difference between the Federal Fund’s total assets, accounts payable and accrued expenses and amounts payable to USDE, excluding amounts payable to PHEAA.

Note 5 – Student Loans Receivable, net

The following table shows our student loan holdings.

(Dollars in thousands)		**September 30, 2016**	June 30, 2016
FFEL:			
Consolidation	$	**4,544,622**	4,705,793
Stafford		**1,018,846**	1,074,457
PLUS		**97,340**	104,978
Supplemental Loans for Students		**944**	987
		5,661,752	5,886,215
HEAL		**25,679**	27,974
Private		**23,372**	28,789
Unamortized premium on student loan purchases		**7,455**	8,203
Unamortized discount on student loan purchases		**(10,968)**	(11,913)
		5,707,290	5,939,268
Allowance for loan losses		**(9,612)**	(21,229)
Student loans receivable, net	$	**5,697,678**	5,918,039

Allowance for loan losses

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

When a student loan defaults, the guarantor reimburses the lender based on the disbursement date of the student loan. We record a charge-off for the difference between the ending balance of the student loan and the reinsurance rate. In the table that follows, we report the “provision for losses – FFEL program loans” and the “provision for losses - other program loans (Non-FFEL)” as the “provision for loan losses” in the Statements of Revenues, Expenses and Changes in Net Position.

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

(Dollars in thousands)		**September 30, 2016**	June 30, 2016
Balance at beginning of period	$	**21,229**	20,871
Provision for losses – FFEL program loans		**276**	7,882
Provision for losses – other program loans (Non-FFEL)		**246**	(1,141)
Charge-offs/Write-offs		**(12,139)**	(6,383)
Balance at end of period	$	**9,612**	21,229

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

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015
Provision for losses – FFEL program loans	$	**276**	2,805
Provision for losses – other program loans (Non-FFEL)		**246**	(79)
Total provision for loan losses	$	**522**	2,726

Note 6 – Notes and Bonds Payable and Other Financings

The following tables show the activity of our student loan and other financings.

(Dollars in thousands) As of and for the three months ended September 30, 2016		Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Student loan financings:						
Student loan floating rate notes, due 2028 - 2065, at weighted-average rates of 1.27% as of September 30, 2016 and 1.17% as of June 30, 2016.	$	4,545,443	545,523	(189,179)	4,901,787	-
Deferred gain on bond refunding of student loan floating rate notes.		134,067	-	(13,983)	120,084	-
Deferred loss on bond refunding of student loan floating rate notes.		(1,299)	-	179	(1,120)	-
Discount on student loan floating rate notes.		(11,802)	(1,852)	1,062	(12,592)	-
Student loan auction rate security bonds, due 2042 - 2044, at weighted-average rates of 0.73% as of September 30, 2016 and 1.65% as of June 30, 2016.		218,200	-	(11,600)	206,600	-
Student loan financing warehouse facilities, due 2017 - 2018, at weighted-average rates of 0.97% as of September 30, 2016 and 1.70% as of June 30, 2016.		738,213	-	(446,872)	291,341	291,341
Student loan financings, due on demand, at weighted-average rates of 1.28% as of September 30, 2016 and 1.20% as of June 30, 2016.		200,000	-	-	200,000	200,000
Total student loan financings	$	5,822,822	543,671	(660,393)	5,706,100	491,341

(Dollars in thousands)

As of and for the three months ended September 30, 2016		Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Other financings:						
Capital acquisition refunding bonds, Series of 2012, due 2016 – 2022, at weighted- average rates of 4.15% as of September 30, 2016 and June 30, 2016.	$	26,195	-	-	26,195	3,895
Unamortized premium on capital acquisition refunding bonds		2,154	-	(156)	1,998	-
Term financings, due 2029, at zero percent interest as of September 30, 2016 and June 30, 2016		6,280	-	-	6,280	-
Total other financings		34,629	-	(156)	34,473	3,895
Total student loan and other financings	$	5,857,451	543,671	(660,549)	5,740,573	495,236

The note and bond indentures, among other things, require us to comply with various covenants, such as parity ratio requirements and annual financial statement, servicing and administration audits. Student loans and investments collateralize all student loan financings. As of September 30, 2016, $5.7 billion of student loan principal and related interest receivable and $300.6 million of cash equivalents collateralized the $5.6 billion of student loan financings.

As of September 30, 2016, the student loan financings and other financings are non-recourse obligations to our unrestricted net position and to the Commonwealth, except for the $200.0 million of student loan financings and $26.2 million of Capital Acquisition Refunding Bonds, Series of 2012, which are recourse obligations to us.

Student loan financings

For the three months ended September 30, 2016, the student loan financings increased $543.7 million due to the PHEAA Student Loan Trust 2016-1 ("2016-1 Trust") bond refunding on September 14, 2016. On September 14, 2016, the 2016-1 Trust issued $534.0 million of original principal amount of student loan asset backed notes, Class A ("Class A Notes"), at par, and $11.6 million of original principal amount of student loan asset backed notes, Class B ("Class B Notes"), at a discount. The Class A Notes were issued with an interest rate of 1-month LIBOR plus 1.15% and a final maturity of September 25, 2065. The Class B Notes had a price to public of 84.00%, which resulted in a discount of $1.9 million. The Class B Notes were issued with an interest rate of 1-month LIBOR plus 1.50% and a final maturity date of September 25, 2065.

For the three months ended September 30, 2016, the student loan financings decreased $660.4 million due to required debt payments, scheduled amortization of deferred gains and losses on bond refundings and scheduled amortization of discounts on student loan floating rate notes. In addition, as part of the bond refunding that took place on September 14, 2016, $415.4 million of the bond proceeds were used to pay down the student loan financing warehouse facilities.

Debt service requirements

The following table 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**
2017	$ 491,341	70,693	$ 3,895	2,089
2018	-	66,323	4,055	791
2019	-	66,323	4,230	617
2020	-	66,323	4,415	436
2021	-	66,323	4,595	247
2022-2026	-	331,615	5,005	51
2027-2031	278,575	323,112	6,280	-
2032-2036	161,634	311,632	-	-
2037-2041	1,976,652	216,887	-	-
2042-2046	1,887,972	80,438	-	-
2047-2051	14,850	60,438	-	-
2052-2056	-	60,418	-	-
2057-2061	243,181	49,034	-	-
2062-2066	545,523	37,719	-	-
	$ 5,599,728	1,807,278	$ 32,475	4,231

The student loan financings are variable-rate debt, which have interest rates that reset on various dates. As of September 30, 2016, interest rates on $206.6 million reset based upon auctions every 28 days, $5.1 billion is indexed to the 1-month or 3-month LIBOR, and $291.3 million is indexed to the asset-backed commercial paper rate.

Note 7 – Segment Information

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

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the three months ended September 30,		**2016**	2015
Interest revenue	$	**35,933**	38,204
Interest expense		**(6,243)**	(10,472)
Net interest revenue		**29,690**	27,732
Provision for loan losses		**88**	(2,618)
Net interest revenue after provision for loan losses		**29,778**	25,114
Total noninterest revenue		**101**	(13)
Total operating revenues		**29,879**	25,101
Operating expenses		**(13,415)**	(11,523)
Operating income		**16,464**	13,578
Transfers to unrestricted net position		**(25,758)**	(783)
Changes in net position		**(9,294)**	12,795
Net position, beginning of period		**310,324**	263,381
Net position, end of period	$	**301,030**	276,176

Statements of Net Position

(Dollars in thousands)		September 30, 2016	June 30, 2016
Current assets:			
Restricted cash and cash equivalents	$	**300,550**	218,582
Student loans receivable		**933,787**	947,881
Interest income receivable		**71,285**	72,787
Other assets		**17**	8
Total current assets		**1,305,639**	1,239,258
Long-term assets:			
Student loans receivable, net		**4,722,130**	4,914,498
Total long-term assets		**4,722,130**	4,914,498
Total assets		**6,027,769**	6,153,756
Deferred outflow of resources:			
Deferred loss on bond refundings		**1,120**	1,299
Total deferred outflow of resources		**1,120**	1,299
Current liabilities:			
Accounts payable and accrued expenses		**20,639**	20,610
Student loan financings		**491,342**	938,213
Total current liabilities		**511,981**	958,823
Long-term liabilities:			
Student loan financings, net		**5,095,794**	4,751,841
Total long-term liabilities		**5,095,794**	4,751,841
Total liabilities		**5,607,775**	5,710,664
Deferred inflow of resources:			
Deferred gain on bond refundings		**120,084**	134,067
Total deferred inflow of resources		**120,084**	134,067
Net position:			
Restricted for debt service		**301,030**	310,324
Total net position	$	**301,030**	310,324

Statements of Cash Flows

(Dollars in thousands)

For the three months ended September 30,		2016	2015
Cash flows from operating activities			
Interest received on student loans	$	**17,132**	16,325
Principal received on student loans		**242,004**	287,199
Student loan purchases		**(205,700)**	(195,275)
Student loan sales, including net gains and losses		**190,552**	181,098
Other		**-**	19
Payment of operating expenses		**(9,282)**	(9,658)
Net cash provided by operating activities		**234,706**	279,708
Cash flows from noncapital financing activities			
Proceeds from the issuance of noncapital debt		**543,671**	-
Principal paid on noncapital debt		**(647,651)**	(275,815)
Interest paid on noncapital debt		**(18,329)**	(15,965)
Bond issuance costs		**(4,817)**	(1,456)
Other		**(25,758)**	(783)
Net cash used for noncapital financing activities		**(152,884)**	(294,019)
Cash flows from investing activities			
Interest received on investments		**146**	9
Net cash provided by investing activities		**146**	9
Net change in restricted cash and cash equivalents		**81,968**	(14,302)
Restricted cash and cash equivalents, beginning of period		**218,582**	253,339
Restricted cash and cash equivalents, end of period	$	**300,550**	239,037

There are nineteen separate trusts with parity ratios, a ratio of assets to liabilities. As of September 30, 2016, the trusts had parity ratios ranging from 1.024 to 1.304. Two of the nineteen trusts have minimum parity ratio requirements and as of September 30, 2016, the trusts complied with the minimum parity ratio requirements.

Note 8 – Blended Component Units

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

The PHEAA SLTs are legally separate entities and we consider them component units of the Foundation, because of their material relationship with the Foundation. The PHEAA SLTs are BCUs of the Foundation, because they provide services entirely for the Foundation.

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

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

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

Statements of Revenues, Expenses and Changes in Net Position

(Dollars in thousands)

For the three months ended September 30, 2016		PHEAA SLTs	PHEF	Total BCUs
Interest revenue	$	**28,942**	**-**	**28,942**
Interest expense		**(2,575)**	**-**	**(2,575)**
Net interest revenue		**26,367**	**-**	**26,367**
Provision for loan losses		**(65)**	**-**	**(65)**
Net interest revenue after provision for loan losses		**26,302**	**-**	**26,302**
Operating expenses		**(10,666)**	**-**	**(10,666)**
Operating income		**15,636**	**-**	**15,636**
Total transfers and financial aid		**(3,211)**	**-**	**(3,211)**
Changes in net position		**12,425**	**-**	**12,425**
Net position, beginning of period		**188,264**	**-**	**188,264**
Net position, end of period	$	**200,689**	**-**	**200,689**

(Dollars in thousands)

For the three months ended September 30, 2015		PHEAA SLTs	PHEF	Total BCUs
Interest revenue	$	30,761	-	30,761
Interest expense		(7,347)	-	(7,347)
Net interest revenue		23,414	-	23,414
Provision for loan losses		(2,603)	-	(2,603)
Net interest revenue after provision for loan losses		20,811	-	20,811
Operating expenses		(8,423)	(23)	(8,446)
Operating income (loss)		12,388	(23)	12,365
Total transfers and financial aid		(1,630)	-	(1,630)
Changes in net position		10,758	(23)	10,735
Net position, beginning of period		143,037	266	143,303
Net position, end of period	$	153,795	243	154,038

Statements of Net Position

(Dollars in thousands)

As of September 30, 2016		PHEAA SLTs	PHEF	Total BCUs
Current assets:				
Restricted cash and cash equivalents	$	159,103	-	159,103
Student loans receivable		790,655	-	790,655
Interest income receivable		63,340	-	63,340
Other assets		17	-	17
Total current assets		1,013,115	-	1,013,115
Long-term assets:				
Student loans receivable, net		3,915,563	-	3,915,563
Total long-term assets		3,915,563	-	3,915,563
Total assets		4,928,678	-	4,928,678
Total deferred outflow of resources		692	-	692
Current liabilities:				
Accounts payable and accrued expenses		17,664	-	17,664
Student loan financings		196,445	-	196,445
Total current liabilities		214,109	-	214,109
Long-term liabilities:				
Student loan financings, net		4,394,488	-	4,394,488
Total long-term liabilities		4,394,488	-	4,394,488
Total liabilities		4,608,597	-	4,608,597
Total deferred inflow of resources		120,084	-	120,084
Net position:				
Restricted for debt service		200,689	-	200,689
Total net position	$	200,689	-	200,689

(Dollars in thousands)

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

Statements of Cash Flows

(Dollars in thousands)

For the three months ended September 30, 2016		PHEAA SLTs	PHEF	Total BCUs
Net cash provided by operating activities	$	**18,540**	**-**	**18,540**
Net cash provided by noncapital financing activities		**19,179**	**-**	**19,179**
Net cash provided by investing activities		**114**	**-**	**114**
Net change in restricted cash and cash equivalents		**37,833**	**-**	**37,833**
Restricted cash and cash equivalents, beginning of period equivalents		**121,270**	**-**	**121,270**
Restricted cash and cash equivalents, end of period equivalents	$	**159,103**	**-**	**159,103**

(Dollars in thousands)

For the three months ended September 30, 2015		PHEAA SLTs	PHEF	Total BCUs
Net cash provided by (used for) operating activities	$	242,206	(23)	242,183
Net cash used for noncapital financing activities		(250,221)	-	(250,221)
Net cash provided by investing activities		5	23	28
Net change in restricted cash and cash equivalents		(8,010)	-	(8,010)
Restricted cash and cash equivalents, beginning of period equivalents		155,758	-	155,758
Restricted cash and cash equivalents, end of period equivalents	$	147,748	-	147,748

Note 9 – Net Position

We have net investment in capital assets, which includes land, buildings and improvements, software development, purchased software, information technology equipment, and other tangible assets that are used in our operations. These capital assets are net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. As of September 30, 2016, net investment in capital assets amounted to $83.2 million. As of June 30, 2016, net investment in capital assets amounted to $79.1 million.

We have net position that is restricted for debt service that is held under various indentures related to financing our student loan portfolios. As of September 30, 2016, net position restricted for debt service amounted to $301.0 million. As of June 30, 2016, net position restricted for debt service amounted to $310.3 million.

We have net position that is restricted for financial aid grant programs, because of the Commonwealth of Pennsylvania grants and federal grants that relate to specific programs. The net position is restricted until we disburse program-related grants. As of September 30, 2016, net position restricted for financial aid grant programs amounted to $70.3 million. As of June 30, 2016, net position restricted for financial aid grant programs amounted to $52.1 million.

We have net position that is unrestricted, which is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Under Commonwealth law, our purpose is to increase higher education opportunities for Pennsylvania residents. Net position that we report as unrestricted are statutorily restricted to our purpose. The Higher Education Amendments of 1998 also restricts our use of net position related to FFEL guaranty activities to fulfilling our guaranty responsibilities and other student financial aid related activities selected by us. Because that restriction is consistent with our statutory purpose, we consider net position related to those activities to be unrestricted. As of September 30, 2016, unrestricted net position amounted to $328.8 million of which net position related to the guaranty activities was $145.1 million. As of June 30, 2016, unrestricted net position amounted to $310.2 million of which net position related to the guaranty activities was $156.9 million.

Note 10 – Risk Management, Contingencies, and Legal Proceedings

Risk Management and Contingencies

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

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

Legal Proceedings

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

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

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

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

Dr. Oberg appealed a second time. The Fourth Circuit vacated the dismissal of the claims against PHEAA and remanded the case to the district court "to permit limited discovery on the question of whether PHEAA is 'truly subject to sufficient state control to render [it] a part of the state'."

On remand, following discovery, PHEAA moved for summary judgment, arguing that there was no genuine issue of material fact and PHEAA was entitled to judgment as a matter of law because discovery confirmed that it is an arm of the Commonwealth. The district court granted the motion on January 16, 2015.

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

On November 17, 2015, the Fourth Circuit denied PHEAA's request for a rehearing by all of the judges of the Fourth Circuit (a "rehearing *enbanc*"). On February 16, 2016, PHEAA filed a *petition for writ of certiorari* with the United States Supreme Court ("Supreme Court"). On May 16, 2016, the Supreme Court invited the Solicitor General of the United States to file a brief regarding whether certiorari should be granted in this case. PHEAA met with the Solicitor General on July 26, 2016, to present its position in favor of certiorari. The Solicitor General has not yet briefed the Supreme Court on the issue, and the Supreme Court has not yet ruled on PHEAA's petition for writ of certiorari. If the Supreme Court decides not to hear the appeal, the case will proceed on the merits. As of September 30, 2016, and through the date of this report, we believe it is remote that a loss contingency exists, and we will continue to contest this matter vigorously.

Lastly, we are involved in various legal matters in the normal course of business. We have considered the available information on these legal matters, and the criteria for a loss contingency, as defined by GASB, does not exist as of September 30, 2016 and through the date of this report.