

Combined Financial Statements
and Required Supplementary Information

2018

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018



Combined Financial Statements
and Required Supplementary Information

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

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Independent Auditors' Report



Board of Directors
Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Frankfort, Kentucky

Report on the Financial Statements

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the "Authority/Corporation"), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Authority/Corporation's combined financial statements as listed in the accompanying table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of Kentucky Education Savings Plan Trust, which statements reflect total assets of \$212,194,121 as of June 30, 2018, and an increase to fiduciary net position of \$12,352,322 for the year ended June 30, 2018. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Kentucky Education Savings Plan Trust, is solely based on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of

the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the report of other auditors, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Authority/Corporation as of June 30, 2018, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle – Adoption of GASB Accounting Standard

As discussed in Note U to the financial statements, the Organization adopted Government Accounting Standards Board ("GASB") Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective as of July 1, 2017. The implementation of this accounting standard resulted in a restatement of prior year net position. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (unaudited) on pages 3 through 16 and the required supplemental information on pages 74 through 79 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the combined financial statements in an appropriate operational, economic, or historical context. We and other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated September 25, 2018, on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority/Corporation's internal control over financial reporting and compliance.

STROTHMAN AND COMPANY

Louisville, Kentucky
September 25, 2018

Management's Discussion and Analysis (Unaudited)

Kentucky Higher Education Assistance Authority/ Kentucky Higher Education Student Loan Corporation

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Description of the Business

The Kentucky Higher Education Assistance Authority (the "Authority" or "KHEAA") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. To that end, KHEAA administers multiple financial aid programs and disseminates information about higher education opportunities. The Authority also guarantees existing Federal Family Education Loan Program ("FFELP") loans, performs default aversion activities, pays lender default and other claims and performs collection activities on eligible student loans. The Kentucky Educational Savings Plan Trust (the "Trust") and the Commonwealth Postsecondary Education Prepaid Trust Fund, Kentucky's Affordable Prepaid Tuition Plan (the "Plan") offer savings and investment opportunities for Kentuckians to save for higher education. The Kentucky Higher Education Student Loan Corporation (the "Corporation" or "KHESLC") makes loans directly to parents, students, and borrowers who are refinancing as part of the Kentucky Advantage loan programs, purchases and/or services eligible Federal and Kentucky Advantage student loans and performs collection activities on certain eligible student loans. The Mission of the organizations is "Helping Kentucky students and families prepare, plan, and pay for higher education." The Vision is "Connecting all Kentuckians to higher education." The Guiding Principles are "Promoting the merits of higher education and improving access, affordability, and completion." The Authority and the Corporation maintain bundled operations to maximize the efficiency of all Authority and Corporation operational and support activities. Accordingly, all senior management positions have responsibilities related to both the Authority and the Corporation. Additionally, the Plan and the Trust are governed by the Authority and Corporation's combined Board of Directors. Throughout the accompanying combined financial statements, the "Authority/Corporation" refers to the combined group of operations.

The Authority/Corporation maintains the following operations:

Outreach - Outreach operations provide critical informational resources to make higher education accessible to Kentucky's current and future generations. Outreach counselors at the Authority/Corporation are available year-round to provide free college planning and financial aid assistance. They conduct scholarship and other funding searches, help students with the admissions and financial aid application processes and increase motivation for at-risk students. Outreach services are offered through classroom presentations, financial aid nights, career fairs, college nights, adult education programs, Kentucky Educational Excellence Scholarship ("KEES") workshops, Free Application for Federal Student Aid ("FAFSA") workshops, PTA and other meetings, financial literacy workshops, professional development/staff training, and other programs and camps. Personnel, professional and administrative costs associated with outreach operations are accounted for as a program benefit in a proprietary fund of the Authority/Corporation.

Student Aid – During FY2018 the Authority/Corporation provided some or all levels of administration of sixteen student aid programs: (1) Kentucky Tuition Grant ("KTG"), (2) College Access Program Grant ("CAP"), (3) Kentucky Educational Excellence Scholarship, (4) Teacher Scholarship, (5) Osteopathic Medicine Scholarship, (6) KHEAA Work-Study Program, (7) Kentucky Coal County College Completion Program, (8) Early Childhood Development Scholarship, (9) Go Higher Grant Program, (10) Coal County Scholarship Program for Pharmacy Students, (11) Work Ready Kentucky Scholarship, (12) John R. Justice Grant, (13) Kentucky National Guard Tuition Award Program, (14) Early Graduation Scholarship, (15) Minority Educator Recruitment and Retention Scholarship, and (16) Dual Credit Scholarship Program.

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Personnel, professional and administrative costs associated with student aid operations are accounted for as a program benefit in a proprietary fund of the Authority/Corporation. Direct benefits to students are accounted for in the governmental fund.

College Savings Programs - The Authority/Corporation administers two savings plans for the Commonwealth of Kentucky; (1) the Trust and (2) the Plan.

The Trust was formed on July 15, 1988, by Kentucky law, to help families save for the costs of higher education. The Trust is administered by the Authority/Corporation's Board of Directors. During FY 2018, the Authority/Corporation contracted with TIAA-CREF Tuition Financing, Inc. ("TFI"), a wholly-owned subsidiary of Teachers Insurance and Annuity Association of America ("TIAA"), for management services over the Trust's Operations. The Trust is operated in a manner such that it is exempt from registration as an investment company under the Investment Company Act of 1940. The Trust offers certain federal and state tax advantages to account owners.

An individual or entity participating in the Trust establishes an account in the name of a Beneficiary. Contributions currently can be made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, the Equity Index Option, the Active Equity Option, and the Guaranteed Option.

Contributions in the Managed Allocation Option are allocated among nine age bands, based on the age of the beneficiary. Each age band invests in varying percentages in the Institutional Class of the International Equity Index, Short-Term Bond, Bond Index, Inflation-Linked Bond, Equity Index, Real Estate Securities, Emerging Market Equity Index, and Guaranteed Funding Agreement of the TIAA-CREF Institutional Mutual Funds.

All allocation percentages are determined by the Authority/Corporation's Board of Directors and are subject to change. The assets of the Guaranteed Option and a percentage of the assets of the five upper level age bands in Managed Allocation are allocated to a funding agreement issued by TIAA-CREF Life Insurance Company, a subsidiary of TIAA, which offers a guarantee of principal and a minimum rate of return to the Trust.

The Equity Options invest in varying percentages in the Institutional Class of the International Equity and Growth & Income Funds of the TIAA-CREF Institutional Mutual Funds.

The Guaranteed Option is contractually obligated to pay a minimum rate of return of 1%. For fiscal year 2018, the Guaranteed investment rate was 1.50%.

The Authority/Corporation also administers the Plan, which was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statutes ("KRS") 164A.700-709.

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan's investment policy goal is to earn rates of return that closely match or exceed anticipated tuition inflation rates and remain sufficiently liquid to meet the Plan's benefit payments in a timely manner. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax

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advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the Plan currently maintains an accumulated net deficit of approximately \$37.4 million.

Participants purchased annual tuition units at then current tuition levels, or tuition levels at the time of purchase, plus a premium, and receive benefits equal to tuition rates in place at the time that the student attends a qualified postsecondary education institution. The Plan offered three tuition plans – the Value Plan, the Standard Plan, and the Premium Plan. In the Value Plan, participants purchased tuition units and receive benefits indexed to the tuition rate of the Kentucky Community and Technical College System. The Standard Plan offers tuition units and benefits indexed to the tuition rate of Kentucky's most expensive public university. The Premium Plan offered tuition units at the then current average tuition cost of Kentucky's private colleges and universities and guarantees a return on a participant's investment equal to the tuition inflation rate for the University of Kentucky.

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, computers, and required supplies.

Participants may withdraw from the Plan at any time for any reason. Terminating participants are refunded any contract payments made less benefits received, administrative and cancellation fees. Participants who withdraw after July 1 of the beneficiary's projected college entrance year receive the statutorily defined payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (1) made on account of the death or disability of the student; (2) made on account of a scholarship received by a student, or (3) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

The Kentucky General Assembly approved certain changes to the Plan during the 2014 Legislative Session that became effective July 2014. These changes included the following: the addition of a utilization period definition; the establishment of June 30, 2028 as the closure date of the Plan; the establishment of certain limitations on the growth of a plan account beyond the utilization period; the prohibition of projected college entrance year extensions; and the clarification of provisions for transferring a plan account to another qualified tuition program.

As of June 30, 2018, the Plan maintained a present value fund deficit of \$37.4 million. This represents a \$4.5 million increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$46 million.

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Certain costs of the Trust and the Plan are accounted for as a program benefit in a proprietary fund of the Authority/Corporation while certain other personnel, professional and administrative costs associated with administering the Trust and the Plan are accounted for in their respective Fiduciary Fund. All assets, liabilities and net position additions and deductions for the Trust are accounted for in the Kentucky Educational Savings Plan Trust fund, a fiduciary fund of the Authority/Corporation. All assets, liabilities and net position additions and deductions for the Plan are accounted for in the Kentucky Affordable Prepaid Tuition fund, a fiduciary fund of the Authority/Corporation.

Loan Guarantee - Loan guarantee operations maintain loan guarantees for qualified students and parents of qualified students made by approved lenders, under the Federal Family Education Loan Program ("FFELP"). The loan guarantee operation is also responsible for providing default aversion assistance to lenders for delinquent loans, reporting loan information to the National Student Loan Data System ("NSLDS"), paying lender claims for loans in default, paying lender claims for death, disability or bankruptcy, and collecting loans on which default claims have been paid. The Authority/Corporation also educates lenders about FFELP requirements and regulatory changes.

Personnel, professional and administrative costs associated with loan guarantee operations are accounted for in the Agency Operating Fund ("AOF"), a proprietary fund of the Authority/Corporation. All federal program activities related to default aversion, claim payment, claim reinsurance from the U.S. Department of Education ("ED"), defaulted loan recoveries and other federally mandated program sources and uses of funds are accounted for in the Federal Student Loan Reserve Fund ("FSLRF"), a fiduciary fund of the Authority/Corporation.

Loan Origination and Disbursement – Loan origination and disbursement operations consist of credit underwriting, loan origination, and issuing disbursements directly to schools or applicable lenders for the Advantage Loan Program. The Advantage Loan Program is comprised of the Advantage Education Loan ("AEL"), Advantage Parent Loan ("APL") and Advantage Refinance Loan ("ARL") Programs.

Personnel, professional and administrative costs associated with loan origination and disbursement operations are accounted for in the proprietary fund of the Authority/Corporation.

School Services – School service operations provide mission focused services to higher education institutions through a contractual relationship. KHEAA Verify simplifies the cumbersome verification process for families and institutions. Cohort Default Management Services help reduce defaults that have severe long term consequences for families and that can impact an institution's participation in both federal and state student aid programs. New areas of services are continuously analyzed and evaluated based on the needs of school partners across the Commonwealth and beyond.

KHEAA Verify consists of services associated with the required verification of the Free Application for Federal Student Aid ("FAFSA") information submitted by potential students at an institution. Cohort Default Management Services engage current and former students of institutions to educate them about persistence and completing their education and/or successfully repaying any educational debt while providing information about the various options available. Personnel, professional and administrative costs associated with school services are accounted for in the Agency Operating Fund ("AOF"), a proprietary fund of the Authority/Corporation and through the collection of revenues generated through service contracts with each institution.

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Loan Finance - The Authority/Corporation's loan finance operation is authorized to refinance existing long-term debt, to originate and acquire private supplemental student loans, and to acquire rehabilitated FFELP loans, FFELP portfolios from other lenders, and certain other FFELP loans required to be repurchased by the Higher Education Act. The Authority/Corporation may issue bonds and notes not to exceed \$5 billion in order to carry out these corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS"), and Federal Consolidation Loans ("Consolidations"). As of June 30, 2018, the loan finance operation held and /or serviced approximately \$989 million of student loans.

Most FFELP loans held by the Authority/Corporation are insured by the Authority/Corporation's loan guarantee operations. FFELP loans made prior to October 1, 1993, are 100% insured. FFELP loans made between October 1, 1993 and June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. FFELP loans made after June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

The Authority/Corporation's loan finance operation finances legacy and certain other FFELP loans with revenue bonds, internal warehouse funds, and commercial bank lines of credit. As of June 30, 2017, the Authority/Corporation maintained seven separate Indentures of Trust and related Series Resolutions for issues of revenue bonds. The indentures contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. As of June 30, 2018, the loan finance operation maintained \$815 million of revenue bonds outstanding and \$60.5 million of lines of credit payable.

Personnel, professional and administrative costs associated with loan finance operations are accounted for in a proprietary fund of the Authority/Corporation.

Loan Servicing - The loan servicing operation performs servicing and default prevention activities on FFELP and supplemental loans held by the Authority/Corporation's loan finance operation and other lenders. Of the loans serviced, approximately \$986 million in outstanding principal of loans was held by the loan finance operation. Over 87% of these loans were pledged pursuant to the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 indenture and the 2017 indenture. Approximately \$2.4 million of FFELP Loans and other education loans were owned by another holder. For those loans, the loan servicing operation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities.

Personnel, professional and administrative costs associated with loan servicing operations are accounted for in a proprietary fund of the Authority/Corporation. Student loan remittances and payables to other lenders are also accounted for in a proprietary fund.

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Industry Update

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of FFELP loans, effective July 1, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on \$1.59 billion of FFELP loans, continues to own \$986 million of FFELP loans and other education loans, and continues to service an additional \$2.4 million of FFELP and other education loans. The Authority/Corporation can no longer originate, guarantee or fund any newly originated FFELP loans; however, the Authority/Corporation does continue to look for opportunities to mitigate the impact of the runoff of the FFELP legacy loan portfolio through the acquisition of FFELP rehabilitation loans and other FFELP portfolios. The expansion of the Advantage Loan Program to include additional jurisdictions for lending eligibility and through strategic partnerships serves as a migration to the risk of reduced revenues through the contraction of the loan portfolio.

The Authority/Corporation plans to leverage its experience collecting defaulted FFELP and Direct Loans to become one of the Private Collection Agencies ("PCA") selected by ED as part of future PCA Request for Proposal processes. In anticipation of future PCA selection processes, the Authority/Corporation sought and received state legislative approval from the Commonwealth of Kentucky to create the Asset Resolution Corporation ("ARC") as the entity that would contract with ED to become a PCA. ARC was created by the Kentucky General Assembly effective July 12, 2012. ARC is attached to KHESLC for administrative and reporting purposes.

On December 26, 2013, former President Obama signed into law the Bipartisan Budget Act of 2013 (the "2013 Budget"). Section 502 of the 2013 Budget reduced the amount that the Authority/Corporation and other guaranty agencies are permitted to retain on rehabilitated defaulted student loans. Under the old rules, guaranty agencies were permitted to retain 18.5% of the principal balance of the rehabilitated loan and 100% of accrued interest, and could charge the borrower up to another 18.5% of the principal balance and accrued interest at the time of loan sale and retain such amount to defray collection costs. For rehabilitated loan sales on and after July 1, 2014, the 2013 Budget required that the guaranty agency 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). In addition, the guaranty agency can charge to the borrower an amount not to exceed 16% of the outstanding principal and interest at the time of the loan sale in order to defray collection costs.

Overview of Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority/Corporation's combined financial statements. The Authority/Corporation's combined financial statements are comprised of the following three components: 1) combined government-wide financial statements, 2) combined fund financial statements, and 3) notes to combined financial statements.

The combined government-wide statement of net position and statement of activities include the Governmental Funds and Proprietary Funds. The combined government-wide financial statements can be found on pages 17 and 18 of this report. The combined fund financial statements can be found on pages 19 through 26 of this report.

Management's Discussion and Analysis (Unaudited)--Continued

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Fiduciary funds are used to account for resources held for the benefit of parties outside the Authority/Corporation. Fiduciary funds are not reflected in the combined government-wide financial statements because the resources are not available to support the Authority/Corporation's programs.

The fiduciary fund statement of net position (deficit) and changes in fiduciary net position (deficit) can be found on pages 27 and 28 of this report.

The Trust publishes separate financial statements and footnotes.

To obtain a copy of the combined financial statements and footnotes, please contact the Authority at (502) 696-7421.

The following is a condensed summary of financial information for the years ended June 30, 2018 and 2017, respectively.

**Kentucky Higher Education Assistance Authority/
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	Governmental Fund		Proprietary Funds	
	2018	2017	2018	2017
Net Position Information				
Capital assets			\$ 6,967,915	\$ 7,553,654
Other assets	\$ 58,747,325	\$ 30,761,529	1,157,026,549	1,191,215,994
Total Assets	58,747,325	30,761,529	1,163,994,464	1,198,769,648
Deferred Outflows of Resources:				
Deferred OPEB expense			4,444,522	
Deferred pension expense			23,937,183	16,820,292
Total Assets and Deferred Outflows of Resources	58,747,325	30,761,529	1,192,376,169	1,215,589,940
Long-term liabilities (2017 Proprietary, as restated)			962,742,321	1,012,109,969
Other liabilities	2,938	405	72,737,365	37,799,836
Deferred pension expense			3,304,972	1,760,586
Deferred OPEB expense			501,385	
Deferred gain on debt retirements, net			14,613,089	16,413,019
Total Liabilities and Deferred Inflows of Resources	2,938	405	1,053,899,132	1,068,083,410
Invested in capital assets, net of expended debt proceeds			5,587,915	5,533,654
Unrestricted			(57,590,161)	(44,670,643)
Restricted, other			101,187,149	98,636,457
Restricted for program benefits	58,744,387	30,761,124		
Restricted for student aid and related activities			89,292,134	88,007,062
Total Net Position, 2017 Restated	\$ 58,744,387	\$ 30,761,124	\$ 138,477,037	\$ 147,506,530
Activity Information				
Interest and investment income fund	\$ 149,833	\$ 445,472	\$ 1,049,590	\$ 700,281
Student aid & advancement fund revenue	257,476,830	234,351,769		
Tobacco settlement revenue	1,100,000	1,100,000		
Unclaimed lottery revenue	9,000,000	8,000,000		
Contributions from Agency Operating Fund	2,140,212	2,097,848		
Federal funds revenue	37,774	17,998		
Servicing Fees from external sources			238,310	257,675
Servicing Fees from Education Finance Funds			5,464,222	5,867,475
Debt recovery commission			21,341,419	22,257,369
Federal fees earned			1,057,030	1,193,001
Default aversion fee income			133,016	67,130
Interest income on loans			15,413,077	15,821,497
Amortization of deferred gain on debt retirements			1,799,930	1,799,930
Guarantee fee				(401)
Gain on the sale of loans			981,914	(3,028)
Late payment penalties			910,811	1,033,829
School Services			965,029	628,368
Other income	543,664	711,512	190,803	159,269
Total Revenue	270,448,313	246,724,599	49,545,151	49,782,395
Kentucky Tuition Grant	29,861,386	28,419,433		
College Access Program Grant	73,573,896	70,494,489		
Early Graduation Scholarship	358,905	312,345		
Mary J Young Scholarship		175,002		
Early Childhood Development Scholarship	905,270	1,107,562		
Kentucky National Guard Tuition Award Program	6,879,596	6,093,150		
Kentucky Educational Excellence Scholarship	115,438,152	113,440,013		
Teacher Scholarship	162,559	874,763		
Teacher Loan Forgiveness	1,400,000	1,400,000		
Osteopathic Medicine Scholarship	316,075	593,462		
KHEAA Work-Study Program	506,192	498,282		
Go Higher Grant Program	302,831	274,430		
Coal County Scholarship Program for Pharmacy Students	367,330	285,560		
Dual Credit Scholarship	6,126,954	4,664,492		
Work Ready Scholarship	3,018,061			
Kentucky Coal County College Completion Scholarship	3,078,184	3,149,137		
John R. Justice Grant	169,659	132,615		
Loan guarantee operations			5,103,731	4,818,756
Default collections			6,757,526	6,724,679
Loan finance and servicing activities			37,745,300	30,852,769
Outreach			3,940,299	4,007,991
Student aid administration			2,140,212	2,053,053
Contribution to student aid programs				44,795
School services			2,752,124	2,405,205
Other activities			135,452	155,494
Total Expenditures	242,465,050	231,914,735	58,574,644	51,062,742
Change in Net Position	\$ 27,983,263	\$ 14,809,864	\$ (9,029,493)	\$ (1,280,347)

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Financial Analysis – Governmental and Proprietary Funds

As previously noted, the Authority and the Corporation maintain bundled operations to maximize the efficiency of operations. Throughout the financial analysis, the "Authority/Corporation" refers to the combined group of operations for both organizations. Financial results for specific operating activities may be discussed as needed to provide appropriate disclosure.

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2018. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets and deferred outflows decreased approximately \$23 million (1.9%), from \$1.22 billion to \$1.19 billion. The decrease was caused primarily by a \$32.2 million decrease in cash and investments and a \$2 million decrease in the receivable from the Federal Student Loan Reserve Fund offset by an \$11.6 million increase to deferred outflows related to GASB 68 and GASB 75 pension and OPEB expense.
- The Authority/Corporation's proprietary fund liabilities and deferred inflows increased \$4.3 million (.4%) from \$1.050 billion to \$1.054 billion. The overall increase in liabilities and deferred inflows was attributable to the net of various decreases and increases year over year. Decreases in liabilities included a \$72.7 million decrease in Bonds payable, a \$3.1 million decrease in the Payable to ED and a \$1.8 million decrease to deferred gain on early retirement of debt. The sum of these decreases were offset by an increase to the Net Pension and OPEB liabilities and deferred inflows related to GASB 68 and GASB 75 pension and OPEB expense of \$44.3 million, an increase to the lines of credit payable of \$37.1 million and a half a million dollar increase in various other liabilities.
- The Authority/Corporation's proprietary fund revenues decreased \$237,000 (.5%), from \$49.8 million to \$49.55 million. The overall decrease was attributable to a number of increases and decreases to certain revenue accounts. However, none of these increases and decreases was in excess of \$1 million year over year. See the condensed financial information schedule for Governmental Fund and Proprietary Funds for the detail of these variances year over year.
- The Authority/Corporation's total proprietary fund expenditures increased approximately \$7.5 million (14.7%), due to the net of various fluctuations. See the condensed financial information schedule for Governmental Fund and Proprietary Funds for a detailed side by side comparison of expenditures for each business-type activity. The majority of the increase is related to loan finance and servicing activities which is primarily attributable to the Corporation's large change in Net Pension and OPEB liabilities.

Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

- The Authority/Corporation's governmental fund assets increased approximately \$28 million (91%) due primarily to a \$26.8 million increase in accounts receivable, an \$848,000 increase in cash and cash equivalents and a \$327,000 increase in noncurrent scholarship loans and advances receivable. The increase in accounts receivable was primarily attributable to continuing appropriation carryover for certain student aid programs as well as from excess lottery proceeds.
- The Authority/Corporation's governmental fund liabilities did not materially change year over year.
- The Authority/Corporation's governmental fund revenues increased approximately \$23.7 million (9.6%), resulting primarily from additional state General Funds for student aid programs.
- The Authority/Corporation's governmental fund expenditures increased \$10.6 million (4.6%) resulting from increases in several student aid programs including, but not limited to, the following: \$1.4 million for Kentucky Tuition Grant, \$3.1 million for College Access Program Grant, \$2 million for Kentucky Educational Excellence Scholarships, \$1.5 million for Dual Credit Scholarship, and \$3 million for Work Ready Scholarship. See the condensed financial information schedule for Governmental Fund and Proprietary Funds for a detailed side by side comparison of Governmental Fund expenditures.

Combined Statement of Net Position – Governmental Fund and Proprietary Funds

Total governmental net position increased from \$30.8 million to \$58.7 million. Total proprietary fund net position decreased \$9 million comprised of a \$14.6 million increase from default collection operations (compared to a \$15.5 million increase in prior year), \$3.5 million decrease from loan guarantee operations (compared to \$3.1 million decrease in prior year), \$3.9 million contribution for outreach activities (compared to \$4 million contribution in prior year), \$2.1 million contribution for student aid administration (compared to \$2.1 million in prior year), \$12.2 million loss in loan finance and servicing activities (compared to \$5.8 million loss in prior year), and \$1.8 million contribution for school services (compared to \$1.8 million in prior year).

Certain highlights related to the combined statement of net position as of June 30, 2018, are as follows:

- The Authority/Corporation maintained \$1.59 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$986 million of FFELP loans and education loans.
- The Authority/Corporation maintained \$322.9 million of defaulted loan principal in its collection portfolio.
- Unrestricted net position is presented as a negative amount reflecting the overall decrease to the Corporation's Operating Fund net position due to GASB 68 and 75.

Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

- Net position, restricted other, increased from \$98.6 million to \$101.2 million.
- Net position restricted for student aid and related activities increased from \$88 million to \$89.3 million.

Combined Statement of Revenues, Expenses and Changes in Net Position

The \$9 million decrease in proprietary fund net position during fiscal year 2018 was \$7.7 million more than the \$1.3 million decrease during fiscal year 2017. The overall decrease in proprietary fund net position was attributable to the net of a \$3.2 million increase for the Authority and a \$12.2 million decrease for the Corporation. The Authority's increase of \$3.2 million was approximately \$1.4 million less than the prior year increase due primarily to \$1 million less of Debt Recover Commissions and increased operating expenses related to pensions and OPEB. The Corporation's loss was largely due to increased pension and OPEB expense. Another critical highlight related to the combined statement of revenues, expenses and changes in net position for the year ended June 30, 2018 is the \$9 million of program benefits provided by the Authority/Corporation. The majority of these program benefits directly benefited the citizens of the Commonwealth of Kentucky.

Management's Discussion and Analysis (Unaudited)

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

	Federal Student Loan Reserve Fund		Kentucky's Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Net Position Information						
Other assets	\$ 25,750,908	\$ 25,810,596	\$ 70,753,666	\$ 82,961,364	\$ 212,194,121	\$ 199,651,763
Total Assets	25,750,908	25,810,596	70,753,666	82,961,364	212,194,121	199,651,763
Total Liabilities	3,911,586	6,264,126	108,131,117	115,850,221	517,832	327,796
Restricted net position (deficit)	21,839,322	19,546,470	(37,377,451)	(32,888,857)	211,676,289	199,323,967
Total Net Position	\$ 21,839,322	\$ 19,546,470	\$ (37,377,451)	\$ (32,888,857)	\$ 211,676,289	\$ 199,323,967
Changes in Fiduciary Net Position Information						
Federal reinsurance	\$ 84,982,446	\$ 105,072,577				
Contribution from Agency Operating Fund						
Fee revenue						
Contributions			\$ 163,440	\$ 187,351		
Subscriptions					\$ 90,372,807	\$ 189,895,506
Investment revenue	84,208	9,340	4,628,321	6,973,724	13,155,854	17,695,446
Other income	2,073,273	2,803,063				
Total Additions	87,139,927	107,884,980	4,791,761	7,161,075	103,528,661	207,590,952
Administrative expenses			375,227	385,356	910,265	815,619
Refunds			2,638,957	2,233,766		
Trustee expense			56,159	304,755		
Tuition benefits expense, net			6,210,012	1,299,075		
Loan claims	84,714,059	104,822,902				
Redemptions					90,266,074	189,532,365
Default aversion	133,016	67,130				
Total Deductions	84,847,075	104,890,032	9,280,355	4,222,952	91,176,339	190,347,984
Change in Net Position	\$ 2,292,852	\$ 2,994,948	\$ (4,488,594)	\$ 2,938,123	\$ 12,352,322	\$ 17,242,968

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Financial Analysis – Fiduciary Funds

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's fiduciary fund performance for the fiscal year ended June 30, 2018. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- Loan claims paid decreased from \$105 million in fiscal year 2017 to \$85 million in fiscal year 2018 (19% decrease).
- The Plan noted an increase in the Net Deficit of \$4.5 million in fiscal year 2018, due primarily to the net of several different factors including the following: gains due to favorable tuition inflation and investment experience, certain changes in program assumptions, and the projected deficit increase represented by interest on the beginning deficit amount.

Statement of Fiduciary Net Position (Deficit)

The FSLRF net position increased \$2.3 million over ending net position in the prior year. Assets decreased by approximately \$3.6 million while liabilities decreased \$5.9 million. 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% (see Notes E and S). Therefore, the Authority/Corporation has not recorded a reserve at June 30, 2018 for losses on federal reinsurance. The reinsurance complement to the FSLRF for collections of defaulted student loans has subsequently resulted in year over year increases to the FSLRF net position.

The Plan's total assets decreased \$12.3 million, from \$83 million as of June 30, 2017 to \$70.7 million as of June 30, 2018. Total liabilities decreased \$7.7 million from \$115.8 million to \$108.1 million. The change in tuition and investment return assumptions, as applicable, are as follows:

- 2018-thereafter – The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. The gross investment yield assumption utilized in the calculation of the tuition benefit payable is based on an investment glide path approach for the Plan. The investments in the Plan will change over time to asset allocations that will reduce equity exposure and try to preserve investment gains. A glide path approach should better match projected payouts as the value of the Plan's assets continues to move closer to its depletion date.
- 2018-2019 academic year – tuition increase assumption was 6.00%, while actual tuition increases were 4.1% for the Value Plan and 2.5% for the Standard Plan and the Premium Plan
- 2018-thereafter – tuition increase assumption remained at 6.00% for each year thereafter until 2026 when all current participant standard utilization periods will expire. The 3% growth limit will apply to remaining accounts through the end of the program in 2028.

Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total net position increased approximately \$12.4 million due primarily to \$13.2 million of investment revenues.

Statement of Changes in Fiduciary Net Position (Deficit)

The FSLRF net position increased \$2.3 million over ending net position in the prior year. Assets decreased nearly \$3.6 million while liabilities decreased \$5.9 million. As noted above, the reinsurance complement to the FSLRF for collections of defaulted student loans has subsequently resulted in year over year increases to the FSLRF net position.

The Plan noted an increase in the Net Deficit of \$4.5 million in fiscal year 2018, due primarily to the net of several different factors including the following: gains due to favorable tuition inflation and investment experience, certain changes in program assumptions, and the projected deficit increase represented by interest on the beginning deficit amount.

Combined Government-Wide Statement of Net Position

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 6,361,124	\$ 29,836,413	\$ 36,197,537
Accounts receivable and prepaid expenses	42,619,114	1,046,139	43,665,253
Accrued interest income		20,868,903	20,868,903
Investments		4,197,817	4,197,817
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		152,099,499	152,099,499
Total Current Assets	49,430,238	208,048,771	257,479,009
Noncurrent:			
Restricted cash and cash equivalents		43,455,294	43,455,294
Receivable from U.S. Department of Education		252,100	252,100
Receivable from Federal Student Loan Reserve Fund		3,105,471	3,105,471
Investments		85,898,713	85,898,713
Fixed assets, net		6,967,915	6,967,915
Loans, net		810,294,180	810,294,180
Teacher and Osteopathic Medicine scholarship loans, net	4,477,326		4,477,326
Teacher and Osteopathic Medicine scholarship advances	4,839,761		4,839,761
Accrued interest income, net		5,972,020	5,972,020
Total Noncurrent Assets	9,317,087	955,945,693	965,262,780
Total Assets	58,747,325	1,163,994,464	1,222,741,789
Deferred Outflows of Resources:			
Deferred OPEB expense		4,444,522	4,444,522
Deferred pension expense		23,937,183	23,937,183
Total Assets and Deferred Outflows of Resources	58,747,325	1,192,376,169	1,251,123,494
LIABILITIES			
Current:			
Accounts payable and accrued expenses	2,938	6,452,573	6,455,511
Accrued interest expense		2,376,742	2,376,742
Payable to US Department of Education		2,778,183	2,778,183
Line of credit payable		60,459,867	60,459,867
Capital lease payable		670,000	670,000
Total Current Liabilities	2,938	72,737,365	72,740,303
Noncurrent:			
Allowance for arbitrage liabilities		369,490	369,490
Net OPEB liability		23,299,457	23,299,457
Net pension liability		123,006,949	123,006,949
Capital lease payable		710,000	710,000
Bonds payable		815,356,425	815,356,425
Total Noncurrent Liabilities		962,742,321	962,742,321
Total Liabilities	2,938	1,035,479,686	1,035,482,624
Deferred Inflows of Resources:			
Deferred pension expense		3,304,972	3,304,972
Deferred OPEB expense		501,385	501,385
Deferred gain on debt retirements, net		14,613,089	14,613,089
Total Liabilities and Deferred Inflows of Resources	2,938	1,053,899,132	1,053,902,070
NET POSITION			
Invested in capital assets, net of expended debt proceeds		5,587,915	5,587,915
Restricted, other		101,187,149	101,187,149
Restricted for program benefits	58,744,387		58,744,387
Restricted for student aid and related activities		89,292,134	89,292,134
Unrestricted		(57,590,161)	(57,590,161)
Total Net Position	\$ 58,744,387	\$ 138,477,037	\$ 197,221,424

Combined Government-Wide Statement of Activities

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

For the Year Ended June 30, 2018

			Program Revenue		Net (Expenses) Revenues and Changes in Net Position		
	Direct Expenses	Indirect Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
Kentucky Tuition Grant	\$ 29,700,483	\$ 160,903		\$ 38,516,021	\$ 8,654,635		\$ 8,654,635
College Access Program Grant	73,412,993	160,903		71,581,833	(1,992,063)		(1,992,063)
Early Graduation Scholarship	230,840	128,065		360,895	1,990		1,990
Early Childhood Development Scholarship	762,557	142,713		1,445,772	540,502		540,502
Kentucky National Guard Tuition Award Program	6,736,883	142,713		7,557,335	677,739		677,739
Kentucky Educational Excellence Scholarship	115,277,249	160,903		115,395,890	(42,262)		(42,262)
Teacher Scholarship	1,656	160,903		1,752,802	1,590,243		1,590,243
Teacher Loan Forgiveness	1,400,000				(1,400,000)		(1,400,000)
Dual Credit Scholarship Program	5,993,782	133,172		10,136,232	4,009,278		4,009,278
Osteopathic Medicine Scholarship	173,525	142,550		729,708	413,633		413,633
Work Ready Scholarship	2,885,048	133,013		16,033,013	13,014,952		13,014,952
KHEAA Work-Study Program	363,642	142,550		542,550	36,358		36,358
Go Higher Grant Program	170,942	131,889		303,389	558		558
Coal County Scholarship Program for Pharmacy Students	234,313	133,017		759,093	391,763		391,763
Kentucky Coal County College Completion Program	2,943,151	135,033		5,164,121	2,085,937		2,085,937
John R. Justice Grant	37,774	131,885		169,659			
Total Governmental Activities	240,324,838	2,140,212		270,448,313	27,983,263		27,983,263
Business-Type Activities:							
Loan guarantee operations	5,103,731		\$ 1,568,443			\$ (3,535,288)	(3,535,288)
Default collections	6,757,526		21,341,419			14,583,893	14,583,893
Loan finance and servicing activities	37,745,300		25,534,808			(12,210,492)	(12,210,492)
Outreach	3,940,299					(3,940,299)	(3,940,299)
Student aid administration	2,140,212					(2,140,212)	(2,140,212)
School services	2,752,124		965,029			(1,787,095)	(1,787,095)
Other activities	135,452		135,452				
Total Business-Type Activities	58,574,644		49,545,151			(9,029,493)	(9,029,493)
Total Activities	\$ 298,899,482	\$ 2,140,212	\$ 49,545,151	\$ 270,448,313	27,983,263	(9,029,493)	18,953,770
Change in Net Position					27,983,263	(9,029,493)	18,953,770
Net Position, July 1, 2017, Restated					30,761,124	147,506,530	178,267,654
Net Position, June 30, 2018					\$ 58,744,387	\$ 138,477,037	\$ 197,221,424

Combined Statement of Net Position - Proprietary Funds

Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation

June 30, 2018

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
ASSETS							
Current:							
Cash and cash equivalents	\$ 2,189,967	\$ 15,320,039	\$ 17,510,006		\$ 12,326,407	\$ 12,326,407	\$ 29,836,413
Investments		4,197,817	4,197,817				4,197,817
Accounts receivable and prepaid expenses	29,165	297,695	326,860		719,279	719,279	1,046,139
Accrued interest income		424,199	424,199	\$ 17,661,567	2,783,137	20,444,704	20,868,903
Loans, net				132,690,038	19,409,461	152,099,499	152,099,499
Total Current Assets	2,219,132	20,239,750	22,458,882	150,351,605	35,238,284	185,589,889	208,048,771
Noncurrent:							
Restricted cash and cash equivalents				43,455,294		43,455,294	43,455,294
Receivable from U.S. Department of Education		252,100	252,100				252,100
Receivable from Federal Student Loan Reserve Fund		3,105,471	3,105,471				3,105,471
Investments		77,372,637	77,372,637		8,526,076	8,526,076	85,898,713
Fixed assets, net		6,591,357	6,591,357		376,558	376,558	6,967,915
Loans, net				727,465,870	82,828,310	810,294,180	810,294,180
Accrued interest income, net				5,094,683	877,337	5,972,020	5,972,020
Total Noncurrent Assets		87,321,565	87,321,565	776,015,847	92,608,281	868,624,128	955,945,693
Total Assets	2,219,132	107,561,315	109,780,447	926,367,452	127,846,565	1,054,214,017	1,163,994,464
Deferred Outflows of Resources:							
Deferred OPEB expense		397,548	397,548		4,046,974	4,046,974	4,444,522
Deferred pension expense		2,069,450	2,069,450		21,867,733	21,867,733	23,937,183
Total Deferred Outflows		2,466,998	2,466,998		25,914,707	25,914,707	28,381,705
Total Assets and Deferred Outflows of Resources	2,219,132	110,028,313	112,247,445	926,367,452	153,761,272	1,080,128,724	1,192,376,169

Combined Statement of Net Position - Proprietary Funds

Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation

June 30, 2018

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
LIABILITIES							
Current:							
Accounts payable and accrued expenses	605,000	860,549	1,465,549	598,535	4,388,489	4,987,024	6,452,573
Interfund payable (receivable)	1,614,132	(1,269,956)	344,176	(4,510,688)	4,166,512	(344,176)	
Accrued interest expense		11,937	11,937	2,213,214	151,591	2,364,805	2,376,742
Payable to U.S. Department of Education				2,625,753	152,430	2,778,183	2,778,183
Line of credit payable					60,459,867	60,459,867	60,459,867
Capital lease payable		670,000	670,000				670,000
Total Current Liabilities	2,219,132	272,530	2,491,662	926,814	69,318,889	70,245,703	72,737,365
Noncurrent:							
Capital lease payable		710,000	710,000				710,000
Net OPEB liability		2,160,437	2,160,437		21,139,020	21,139,020	23,299,457
Net pension liability		11,405,792	11,405,792		111,601,157	111,601,157	123,006,949
Allowance for arbitrage liabilities				369,490		369,490	369,490
Bonds payable, net				815,356,425		815,356,425	815,356,425
Total Noncurrent Liabilities		14,276,229	14,276,229	815,725,915	132,740,177	948,466,092	962,742,321
Total Liabilities	2,219,132	14,548,759	16,767,891	816,652,729	202,059,066	1,018,711,795	1,035,479,686
Deferred Inflows of Resources:							
Deferred pension expense		929,572	929,572		2,375,400	2,375,400	3,304,972
Deferred OPEB expense		46,491	46,491		454,894	454,894	501,385
Deferred gain on debt retirements, net				14,613,089		14,613,089	14,613,089
Total Liabilities and Deferred Inflows of Resources	2,219,132	15,524,822	17,743,954	831,265,818	204,889,360	1,036,155,178	1,053,899,132
NET POSITION							
Invested in capital assets, net		5,211,357	5,211,357		376,558	376,558	5,587,915
Restricted, other				95,101,634	6,085,515	101,187,149	101,187,149
Restricted for student aid and related activities		89,292,134	89,292,134				89,292,134
Unrestricted					(57,590,161)	(57,590,161)	(57,590,161)
Total Net Position	\$	\$ 94,503,491	\$ 94,503,491	\$ 95,101,634	\$ (51,128,088)	\$ 43,973,546	\$ 138,477,037

Combined Statement of Revenues, Expenditures and Changes
in Net Position - Proprietary Funds

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

For the Year Ended June 30, 2018

	Authority		Corporation			Combined	
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating Revenues:							
Interest Revenues:							
Interest on loans			\$ 32,689,203	\$ 3,008,697	\$ 35,697,900	\$ 35,697,900	
Interest and investment income	\$ 378,397	\$ 378,397	580,611	90,582	671,193	1,049,590	
Amortization of deferred gain on debt retirements			1,799,930		1,799,930	1,799,930	
Interest expense on bonds			(19,434,482)	(850,341)	(20,284,823)	(20,284,823)	
Total Net Interest Revenues	378,397	378,397	15,635,262	2,248,938	17,884,200	18,262,597	
Financing Expenses:							
Provision for loan losses			(29,808)	353,869	324,061	324,061	
Provision for arbitrage			127,532		127,532	127,532	
Long-Term debt credit facility and remarketing fees			781,689	66,137	847,826	847,826	
Debt issuance costs			874,806		874,806	874,806	
Total Financing Expenses			1,754,219	420,006	2,174,225	2,174,225	
Interest Revenues Net of Financing Expenses	378,397	378,397	13,881,043	1,828,932	15,709,975	16,088,372	
Other Operating Revenues:							
Servicing fees from external sources				238,310	238,310	238,310	
Servicing fees from Education Finance Funds				5,464,222	5,464,222	5,464,222	
Debt recovery commission	21,341,419	21,341,419				21,341,419	
Federal fees earned	1,057,030	1,057,030				1,057,030	
Default aversion fee income	133,016	133,016				133,016	
Gain/(loss) on sale/purchase of loans			985,109	(3,195)	981,914	981,914	
Late payment penalties			890,875	19,936	910,811	910,811	
School services	965,029	965,029				965,029	
Other income	\$ 135,452	\$ 135,452		55,351	55,351	190,803	
Total Operating Revenues	135,452	23,874,891	15,757,027	7,603,556	23,360,583	47,370,926	

Combined Statement of Revenues, Expenditures and Changes
in Net Position - Proprietary Funds

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

For the Year Ended June 30, 2018

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating Expenses:							
Administrative expenses	135,452	11,426,983	11,562,435		28,734,457	28,734,457	40,296,892
Servicing fees for Operating Fund				5,464,222		5,464,222	5,464,222
Depreciation and amortization		426,960	426,960		261,945	261,945	688,905
Other expenses		7,314	7,314	151,636	743,566	895,202	902,516
Total Operating Expenses	135,452	11,861,257	11,996,709	5,615,858	29,739,968	35,355,826	47,352,535
Net Operating Income (Loss) Before Program Benefits		12,013,634	12,013,634	10,141,169	(22,136,412)	(11,995,243)	18,391
Program Benefits:							
Principal and interest benefits				214,945	304	215,249	215,249
School Service		2,752,124	2,752,124				2,752,124
Outreach		3,940,299	3,940,299				3,940,299
Student aid administration		2,140,212	2,140,212				2,140,212
Total Program Benefits		8,832,635	8,832,635	214,945	304	215,249	9,047,884
Operating Income (Loss) Before Transfers		3,180,999	3,180,999	9,926,224	(22,136,716)	(12,210,492)	(9,029,493)
Transfers (to) from Other Funds							
Interfund transfers				(6,249,685)	6,249,685		
Increase (Decrease) in Net Position After Transfers		3,180,999	3,180,999	3,676,539	(15,887,031)	(12,210,492)	(9,029,493)
Net Position, July 1, 2017, Restated		91,322,492	91,322,492	91,425,095	(35,241,057)	56,184,038	147,506,530
Net Position, June 30, 2018	\$ -	\$ 94,503,491	\$ 94,503,491	\$ 95,101,634	\$ (51,128,088)	\$ 43,973,546	\$ 138,477,037

Combined Statement of Cash Flows - Proprietary Funds

Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation

For the Year Ended June 30, 2018

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Cash Flows from Operating Activities:							
Principal received on loans				\$ 137,955,202	\$ 12,776,521	\$ 150,731,723	\$ 150,731,723
Interest received on loans				27,891,281	(14,596)	27,876,685	27,876,685
Special allowance paid				(13,022,366)	(1,267,359)	(14,289,725)	(14,289,725)
Servicing fees received, internal sources	\$ (135,452)	\$ (99,064)	\$ (234,516)	(5,464,222)	5,464,222		(234,516)
School services fees received		965,029	965,029				965,029
Servicing fees received, external sources					267,395	267,395	267,395
Debt recovery commission received		21,341,419	21,341,419				21,341,419
Federal fees received		1,057,030	1,057,030				1,057,030
Default aversion fees received		133,016	133,016				133,016
Outreach		(3,940,299)	(3,940,299)				(3,940,299)
School services		(2,752,124)	(2,752,124)				(2,752,124)
Internal activity-payments to other funds	(528,006)	528,006		(2,826,924)	2,826,924		
Loans originated, including costs				(2,719,768)	(60,996,922)	(63,716,690)	(63,716,690)
Administrative expenses paid		(9,738,286)	(9,738,286)	(2,749,927)	(16,156,966)	(18,906,893)	(28,645,179)
Credit facility fees paid				(781,689)	(63,839)	(845,528)	(845,528)
Loans purchased, including premiums		(2,140,212)	(2,140,212)	(1,691,552)	(61,644,025)	(63,335,577)	(63,335,577)
Student aid administration							
Interfund loan sales and purchases				(69,805,440)	69,805,440		
Client loan receipts					883,416	883,416	883,416
Loan receipts remitted to clients					(870,047)	(870,047)	(870,047)
Net Cash Provided By (Used In) Operating Activities	(663,458)	5,354,515	4,691,057	66,784,595	(48,989,836)	17,794,759	22,485,816
Cash Paid from Noncapital Financing Activities:							
Proceeds from debt issued				171,068,000	72,038,959	243,106,959	243,106,959
Debt principal payments				(243,549,000)	(34,990,298)	(278,539,298)	(278,539,298)
Interest on debt				(18,967,231)	(740,649)	(19,707,880)	(19,707,880)
Debt issuance costs				(874,806)		(874,806)	(874,806)
Interfund transfers				(6,249,685)	6,249,685		
Increase in Federal Student Loan Reserve receivable		1,964,875	1,964,875				1,964,875
Net Cash Provided By (Used In) Noncapital Financing Activities		1,964,875	1,964,875	(98,572,722)	42,557,697	(56,015,025)	(54,050,150)
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(345,006)	(345,006)		(130,024)	(130,024)	(475,030)
Interest paid on capital lease		(640,000)	(640,000)				(640,000)
Bond principal payments		(5,246)	(5,246)				(5,246)
Net Cash Used In Capital and Related Financing Activities		(990,252)	(990,252)		(130,024)	(130,024)	(1,120,276)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		61,303,814	61,303,814		6,686,961	6,686,961	67,990,775
Purchases of investments		(71,054,479)	(71,054,479)		(6,810,221)	(6,810,221)	(77,864,700)
Investment income		508,010	508,010	562,783	155,760	718,543	1,226,553
Net Cash Provided By (Used In) Investing Activities		(9,242,655)	(9,242,655)	562,783	32,500	595,283	(8,647,372)
Net (Decrease) in Cash and Cash Equivalents	(663,458)	(2,913,517)	(3,576,975)	(31,225,344)	(6,529,663)	(37,755,007)	(41,331,982)
Cash and Cash Equivalents, July 1, 2017	2,853,425	18,233,556	21,086,981	74,680,638	18,856,070	93,536,708	114,623,689
Cash and Cash Equivalents, June 30, 2018	\$ 2,189,967	\$ 15,320,039	\$ 17,510,006	\$ 43,455,294	\$ 12,326,407	\$ 55,781,701	\$ 73,291,707

Combined Statement of Cash Flows - Proprietary Funds

Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation

For the Year Ended June 30, 2018

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Reconciliation of Operating Income to Net Cash Provided By (Used In) Operating Activities							
Operating income (loss) before transfers		\$ 3,180,999	\$ 3,180,999	\$ 9,926,224	\$ (22,136,716)	\$ (12,210,492)	\$ (9,029,493)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income				(562,783)	(84,849)	(647,632)	(647,632)
Depreciation and amortization		798,824	798,824		261,945	261,945	1,060,769
Amortization of deferred gain on debt retirements				(1,799,930)		(1,799,930)	(1,799,930)
Amortization, expense and write-off of debt issuance costs				874,806		874,806	874,806
Interest expense		5,246	5,246	19,434,482	850,341	20,284,823	20,290,069
Provision for loan losses				(29,808)	353,869	324,061	324,061
Borrower interest converted to principal				(15,940,794)	(1,688,941)	(17,629,735)	(17,629,735)
Loan forgiveness				214,945	298	215,243	215,243
Pension expense		736,898	736,898		11,544,252	11,544,252	12,281,150
OPEB expense		99,635	99,635		1,932,399	1,932,399	2,032,034
(Increases) decreases in assets:							
Accounts receivables and prepaid expenses	\$ (29,165)	(222,777)	(251,942)		3,205	3,205	(248,737)
Accrued interest receivable		123,713	123,713	(3,552,257)	(2,439,957)	(5,992,214)	(5,868,501)
Principal received on loans				137,955,202	12,776,521	150,731,723	150,731,723
Loans purchased, including premiums				(1,691,552)	(61,644,025)	(63,335,577)	(63,335,577)
Loans originated, including costs				(2,719,768)	(60,996,922)	(63,716,690)	(63,716,690)
Interfund loan sales and purchases				(69,805,440)	69,805,440		
Increases (decreases) in liabilities:							
Accounts payable and accrued expenses	(231,601)	106,335	(125,266)	273,911	54,376	328,287	203,021
Payable to U.S. Department of Education				(3,093,251)	(279,800)	(3,373,051)	(3,373,051)
Interfund receivable/payable	(402,692)	530,888	128,196	(2,826,924)	2,698,728	(128,196)	
Accrued interest payable		(5,246)	(5,246)				(5,246)
Allowance for arbitrage liabilities				127,532		127,532	127,532
Net Cash Provided By (Used In) Operating Activities	<u>\$ (663,458)</u>	<u>\$ 5,354,515</u>	<u>\$ 4,691,057</u>	<u>\$ 66,784,595</u>	<u>\$ (48,989,836)</u>	<u>\$ 17,794,759</u>	<u>\$ 22,485,816</u>

Balance Sheet - Governmental Fund

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

	Governmental Fund <u>Student Aid</u>
ASSETS	
Current:	
Cash and cash equivalents	\$ 6,361,124
Accounts receivable	42,619,114
Teacher and Osteopathic Medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>49,430,238</u>
Noncurrent:	
Teacher and Osteopathic Medicine scholarship loans, net of allowance of \$3,230,000	4,477,326
Teacher and Osteopathic Medicine scholarship advances	<u>4,839,761</u>
Total Noncurrent Assets	<u>9,317,087</u>
Total Assets	<u>58,747,325</u>
LIABILITIES	
Current:	
Accounts payable	<u>2,938</u>
Total Liabilities	<u>2,938</u>
FUND BALANCE	
Restricted for program benefits	<u><u>\$ 58,744,387</u></u>

Statement of Revenues, Expenditures and Changes
in Fund Balance - Governmental Fund

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

For the Year Ended June 30, 2018

	Governmental Fund
	Student Aid
Revenues:	
Interest and investment income fund	\$ 149,833
Tobacco settlement revenue	1,100,000
Unclaimed lottery revenue	9,000,000
State General Fund revenue	257,476,830
Federal funds revenue	37,774
Other income	543,664
Contribution from Agency Operating Fund	2,140,212
	<hr/>
Total Revenues	270,448,313
Expenditures:	
Kentucky Tuition Grant	29,861,386
College Access Program Grant	73,573,896
Early Graduation Scholarship	358,905
Early Childhood Development Scholarship	905,270
Kentucky National Guard Tuition Award Program	6,879,596
Kentucky Educational Excellence Scholarship	115,438,152
Teacher Scholarship	162,559
Teacher Loan Forgiveness	1,400,000
Osteopathic Medicine Scholarship	316,075
Coal County Scholarship Program for Pharmacy Students	367,330
KHEAA Work-Study Program	506,192
Go Higher Grant Program	302,831
Dual Credit Scholarship Program	6,126,954
Work Ready Scholarship	3,018,061
Kentucky Coal County College Completion Program	3,078,184
John R. Justice Grant	169,659
	<hr/>
Total Expenditures	242,465,050
	<hr/>
Net Change in Fund Balance	27,983,263
	<hr/>
Fund Balance, July 1, 2017	30,761,124
	<hr/>
Fund Balance, June 30, 2018	\$ 58,744,387
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Statement of Fiduciary Net Position (Deficit)

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

ASSETS	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Current:			
Cash and cash equivalents	\$ 22,172,200	\$ 1,485,323	
Contributions receivable		265,823	
Fees receivable		195,828	
Receivable from U.S. Department of Education	3,578,708		
Investments		68,497,285	\$ 211,911,728
Other current assets			282,393
Total Current Assets	25,750,908	70,444,259	212,194,121
Noncurrent:			
Contributions receivable		309,407	
Total Assets	25,750,908	70,753,666	212,194,121
LIABILITIES			
Current:			
Accounts payable	771,744	104,537	282,394
Accrued expenses			235,438
Tuition benefits payable		18,645,547	
Other current payables	34,371		
Payable to U.S. Department of Education			
Total Current Liabilities	806,115	18,750,084	517,832
Noncurrent:			
Payable to Agency Operating Fund	3,105,471		
Tuition benefits payable		89,381,033	
Total Liabilities	3,911,586	108,131,117	517,832
NET POSITION (DEFICIT)			
Restricted for program benefits		(37,377,451)	211,676,289
Restricted for other purposes	21,839,322		
Total Net Position (Deficit)	\$ 21,839,322	\$ (37,377,451)	\$ 211,676,289

Statement of Changes in Fiduciary Net Position (Deficit)

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

For the Year Ended June 30, 2018

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Additions:			
Federal reinsurance	\$ 84,982,446		
Contract income, net		\$ 163,440	
Subscriptions			\$ 90,372,807
Investment Revenues:			
Net unrealized gain (loss) on investments		(1,553,769)	9,046,552
Interest and investment income	84,208	6,182,090	4,109,302
Other income	2,073,273		
Total Additions	87,139,927	4,791,761	103,528,661
Deductions:			
Program benefits:			
Loan claims	84,714,059		
Default aversion fee expense	133,016		
Redemptions			90,266,074
Administrative expenses		40,549	910,265
Personnel and professional expenses		334,678	
Refunds		2,638,957	
Trustee fee expense		56,159	
Tuition benefits expense, net		6,210,012	
Total Deductions	84,847,075	9,280,355	91,176,339
Change in Net Position	2,292,852	(4,488,594)	12,352,322
Net Position (Deficit), July 1, 2017	19,546,470	(32,888,857)	199,323,967
Net Position (Deficit), June 30, 2018	\$ 21,839,322	\$ (37,377,451)	\$ 211,676,289

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note A--Description of Business

The Kentucky Higher Education Assistance Authority (the "Authority" or "KHEAA") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. To that end, KHEAA administers several financial aid programs and disseminates information about higher education opportunities. The Authority also guarantees existing Federal Family Education Loan Program ("FFELP") loans, performs default aversion activities, pays lender default and other claims and performs collection activities on eligible student loans. The Kentucky Educational Savings Plan Trust (the "Trust") and the Commonwealth Postsecondary Education Prepaid Trust Fund, Kentucky's Affordable Prepaid Tuition Plan (the "Plan") offer savings and investment opportunities for Kentuckians to save for higher education. The Kentucky Higher Education Student Loan Corporation (the "Corporation" or "KHESLC") makes loans directly to parents, students, and borrowers who are refinancing as part of the Kentucky Advantage loan programs, purchases and/or services eligible Federal and Kentucky Advantage student loans and performs collection activities on certain eligible student loans. The Mission of the organizations is "Helping Kentucky students and families prepare, plan, and pay for higher education. The Vision is "Connecting all Kentuckians to higher education." The Guiding Principles are "Promoting the merits of higher education and improving access, affordability, and completion. The Authority and the Corporation maintain bundled operations to maximize the efficiency of all Authority and Corporation operational and support activities. Accordingly, all senior management positions have responsibilities related to both the Authority and the Corporation. Additionally, the Plan and the Trust are governed by the Authority and Corporation's combined Board of Directors. Throughout the accompanying combined financial statements, the "Authority/Corporation" refers to the combined group of operations.

The Health Care and Education Reconciliation Act ("HCERA") of 2010 was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of new FFELP loans, effective July 1, 2010. HCERA did allow lenders to make subsequent disbursements on loans originated on or before June 30, 2010. The Authority/Corporation can no longer originate, guarantee or fund any newly-originated FFELP loans. However, the Authority/Corporation continues to operate under existing FFELP regulations for loans originated and guaranteed prior to July 1, 2010.

Outreach Programs

The Authority/Corporation offers college planning and student financial aid guidance to students and families, school counselors, adult education providers and other community contacts. Programs and services include regional field counselors, a mobile college-planning classroom, a one-stop Web portal, near-peer college coaches and targeted publications for students of all ages. Initiatives include Kentucky College Application Campaign, which provides participating seniors with hands-on assistance in applying to college or technical school; Close the Deal, which connects students with community leaders and business representatives to set and meet goals for college and future careers; College Decision Day, which celebrates and recognizes seniors for making educational plans beyond high school; *Surviving College*, workshops and publications designed to ease the transition to college for traditional students and adult learners, increasing retention; and the Kentucky College Coaches Program, in which recent college graduates serve as coaches to students in schools with predominantly first-generation, low-income students.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note A--Description of Business--Continued

Student Aid Programs

Student Aid – During FY2018 the Authority/Corporation provided some or all levels of administration of sixteen student aid programs: (1) Kentucky Tuition Grant (“KTG”), (2) College Access Program Grant (“CAP”), (3) Kentucky Educational Excellence Scholarship, (4) Teacher Scholarship, (5) Osteopathic Medicine Scholarship, (6) KHEAA Work-Study Program, (7) Kentucky Coal County College Completion Program, (8) Early Childhood Development Scholarship, (9) Go Higher Grant Program, (10) Coal County Scholarship Program for Pharmacy Students, (11) Work Ready Kentucky Scholarship, (12) John R. Justice Grant, (13) Kentucky National Guard Tuition Award Program, (14) Early Graduation Scholarship, (15) Minority Educator Recruitment and Retention Scholarship, and (16) Dual Credit Scholarship Program.

Kentucky Educational Savings Plan Trust

The Trust was formed on July 15, 1988 by Kentucky law, to help families save for the costs of higher education. The Trust is administered by the Authority/Corporation’s Board of Directors. During FY 2018, the Authority/Corporation contracted with TIAA-CREF Tuition Financing, Inc. (“TFI”), a wholly-owned subsidiary of Teachers Insurance and Annuity Association of America (“TIAA”), for management services over the Trust’s Operations. The Trust is operated in a manner such that it is exempt from registration as an investment company under the Investment Company Act of 1940. The Trust offers certain federal and state tax advantages to account owners.

An individual or entity participating in the Trust establishes an account in the name of a Beneficiary. Contributions can be made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, the Equity Index Option, the Active Equity Option and the Guaranteed Option.

Contributions in the Managed Allocation Option are allocated among nine age bands, based on the age of the beneficiary. Each age band invests in varying percentages in the Institutional Class of the International Equity Index, Short-Term Bond, Bond Index, Inflation-Linked Bond, Equity Index, Real Estate Securities, Emerging Market Equity Index, and Guaranteed Funding Agreement of the TIAA-CREF Institutional Mutual Funds.

All allocation percentages are determined by the Authority/Corporation’s Board of Directors and are subject to change. The assets of the Guaranteed Option and a percentage of the assets of the five upper level age bands in Managed Allocation are allocated to a funding agreement issued by TIAA-CREF Life Insurance Company, a subsidiary of TIAA, which offers a guarantee of principal and a minimum rate of return to the Trust.

The Equity Options invest in varying percentages in the Institutional Class of the International Equity and Growth & Income Funds of the TIAA-CREF Institutional Mutual Funds.

The Guaranteed Option is contractually obligated to pay a minimum rate of return of 1%. For fiscal year 2018, the Guaranteed investment rate was 1.50%.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note A--Description of Business--Continued

Prepaid Tuition Plan

The Authority/Corporation also administers the Plan, which was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statutes ("KRS") 164A.700-709.

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan's investment policy goal is to earn rates of return that closely match or exceed anticipated tuition inflation rates and remain sufficiently liquid to meet the Plan's benefit payments in a timely manner. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the Plan currently maintains an accumulated net deficit of approximately \$37.4 million.

Participants purchased annual tuition units at then current tuition levels, or tuition levels at the time of purchase, plus a premium, and receive benefits equal to tuition rates in place at the time that the student attends a qualified postsecondary education institution. The Plan offered three tuition plans – the Value Plan, the Standard Plan and the Premium Plan. In the Value Plan, participants purchased tuition units and receive benefits indexed to the tuition rate of the Kentucky Community and Technical College System. The Standard Plan offers tuition units and benefits indexed to the tuition rate of Kentucky's most expensive public university. The Premium Plan offers tuition units at the then current average tuition cost of Kentucky's private colleges and universities and guarantees a return on a participant's investment equal to the tuition inflation rate for the University of Kentucky.

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, computers, and required supplies.

Participants may withdraw from the Plan at any time for any reason. Terminating participants are refunded any contract payments made less benefits received, administrative and cancellation fees. Participants who withdraw after July 1 of the beneficiary's projected college entrance year receive the statutorily defined payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (1) made on account of the death or disability of the student; (2) made on account of a scholarship received by a student, or (3) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note A--Description of Business--Continued

The Kentucky General Assembly approved certain changes to the Plan during the 2014 Legislative Session that became effective July 2014. These changes included the following: the addition of a utilization period definition; the establishment of June 30, 2028 as the closure date of the Plan; the establishment of certain limitations on the growth of a plan account beyond the utilization period; the prohibition of projected college entrance year extensions; and the clarification of provisions for transferring a plan account to another qualified tuition program.

As of June 30, 2018, the Plan maintained a present value fund deficit of \$37.4 million. This represents a \$4.5 million increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$46 million.

Loan Guarantee Operations

The Authority/Corporation's loan guarantee operations guarantee existing FFELP loans to qualified students and parents of qualified students made by approved lenders in Kentucky and Alabama. Commencing in 1969, retroactive to 1965, the federal government agreed to insure 80% of such guaranteed student loans. FFELP was established by Congress and is administered by ED as a pre-HCERA means of making loans available to students attending colleges, universities and vocational institutions. FFELP provides for the Authority/Corporation's loan guarantee operations to guarantee the repayment of principal and accrued interest to lenders for each eligible student loan. The Authority/Corporation's loan guarantee operation is responsible for maintaining loan guarantees, providing default aversion assistance to lenders for delinquent loans, reporting loan information to the National Student Loan Data System ("NSLDS"), paying lender claims for loans in default, paying lender specialty claims such as death, disability or bankruptcy and collecting loans on which default claims have been paid. The Authority/Corporation also educates lenders about FFELP requirements and regulatory changes.

Effective January 10, 1977, the Authority/Corporation's loan guarantee operation entered into a supplemental guaranty agreement with the Federal government, which provided up to 100% reimbursement, depending upon default experience as specified in the agreement. Subsequently, federal reinsurance on guaranteed loans made from October 1, 1993 to September 30, 1998 was reduced to a maximum of 98% and federal reinsurance on guaranteed loans made on or after October 1, 1998, was reduced to a maximum of 95%. The maximum reinsurance rate was amended to 100% effective for default claims paid on or after December 1, 2015 (see Note E).

The Higher Education Amendments of 1998 (the "1998 Amendments") which were enacted on October 7, 1998, with an effective date of October 1, 1998, changed the manner in which FFELP is administered. Under the 1998 Amendments, the Authority/Corporation established a Federal Student Loan Reserve Fund (the "FSLRF") and an Agency Operating Fund (the "AOF") to account for all FFELP guarantee activities. FSLRF assets and all earnings on those assets are the property of the Federal government.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note A--Description of Business--Continued

The guarantee reserves of the Authority/Corporation were required to be deposited in the new Federal Fund no later than 60 days after enactment. The result of this federal legislation was that the Authority/Corporation's guarantee reserve fund equity of approximately \$40.6 million was transferred to the newly established FSLRF and the Authority/Corporation's AOF commenced activities with a zero fund equity. The funds in the newly established FSLRF were used to pay for the reimbursements to the lenders for student loan claims and pay the AOF for default aversion fees, Account Maintenance Fee shortfall and any U.S. Treasury recall amounts. Funds used to pay loan claims are primarily replenished from reimbursements from the federal government.

Other sources of revenues to the FSLRF include the federal complement on collections of defaulted loans and investment income. All of the other sources and uses of funds not related to the FSLRF are recorded in the AOF. The AOF assets and earnings on those assets are the property of the Authority/Corporation and are restricted for financial aid related activities including guaranty agency activities.

Sources of funds to the AOF include investment income, agency retention on collections of defaulted loans, default aversion fees, account maintenance fees, and school services revenue. Expenditures from the AOF include personnel, professional and other administrative expenses directly related to the loan program operations, outreach program activities, school services, and other operating activities. The AOF also provides funding to the governmental fund to pay administration costs for multiple student aid programs and administrative costs for the Trust. Both the FSLRF and AOF are subject to federal oversight.

Loan Finance and Servicing Operations

The Corporation is an independent *de jure* municipal corporation established by the Kentucky General Assembly in 1978 to provide a loan finance program for post-secondary students in the Commonwealth of Kentucky. The Corporation is authorized to finance loans for students attending or who have attended eligible post-secondary institutions. In addition, the Corporation services and collects education loans and issues bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties.

The Authority/Corporation's finance, servicing and collection activities include: (i) the origination and acquisition of education loans; (ii) the financing of FFELP and Advantage Loans; (iii) the servicing of FFELP, Advantage, certain federal and other education loans; and (iv) the collection of FFELP, Advantage, certain federal and other education loans for other holders on a commission or cost reimbursement basis. FFELP student loans held, serviced and collected by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS") and Federal Consolidation Loans ("Consolidations").

Most FFELP loans held by the Authority/Corporation are insured by a guaranty agency. FFELP loans made prior to October 1, 1993, are 100% insured. FFELP loans made between October 1, 1993 and June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note A--Description of Business—Continued

98% insured against borrowers' default. FFELP loans made after June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default. Advantage Loans do not have the same insurance as the FFELP loans originated under the federal program; however, upon default, ownership of the loans remain with the Authority/Corporation and debt recovery efforts continue.

The Authority/Corporation's indentures and separate series resolutions for issuance of revenue bonds contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. In addition, the Authority/Corporation's lines of credit also provide for certain collateral account and proceeds restrictions.

As of June 30, 2018, the Authority/Corporation held and/or serviced approximately \$988.6 million outstanding principal amount of FFELP and other education loans. \$865.1 million of loans were pledged pursuant to the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 Indenture, and the 2017 Indenture. The remaining \$121.1 million of loans were funded by the Corporation's Operating Fund. Also, the Authority/Corporation services approximately \$2.4 million of FFELP and other education loans on behalf of other holders. The majority of such education loans are serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP and other education loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

Note B--Summary of Significant Accounting Policies

Basis of Presentation - The Authority/Corporation reports its financial information in accordance with the Government Accounting Standard Board ("GASB") Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments* as amended by GASB No. 37 and modified by GASB No. 38, *Certain Financial Statement Disclosures*, (collectively "GASB No. 34"). The Authority/Corporation's basic financial statements are prepared in accordance with GASB No. 34 and are comprised of the following three components: 1) government-wide financial statements; 2) fund financial statements, and 3) notes to financial statements. The government-wide financial statements are comprised of a statement of net position and a statement of activities. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements reflect all of the assets, liabilities, deferred inflows of resources, deferred outflows of resources, revenues, expenses, gains and losses of the combined Authority/Corporation's governmental and business-type activities. The Authority/Corporation's governmental activities reflect the activities of administering the various student grant, scholarship, advance/loan and work-study programs for the Commonwealth of Kentucky and the Federal Government.

The Authority/Corporation's business-type activities include administering loan guarantees, default collection, loan finance and servicing, outreach program activities, student aid administration and contributions, school services and other activities.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note B--Summary of Significant Accounting Policies--Continued

The combined government-wide financial statements do not reflect fiduciary activities whose resources are not available to finance the Authority/Corporation's programs.

The Authority/Corporation's combined fund financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to state governmental entities, which provide that accounting systems be organized by funds to account for specific activities consistent with legal and operating requirements. The Authority/Corporation's governmental fund includes the activities of administering grant, scholarship, advance/loan programs and the work-study program for the Commonwealth of Kentucky and the Federal Government.

The Authority/Corporation's loan guarantee, default collection, loan finance and servicing, outreach program activities, student aid administration and contributions, school services and other business-type activities are presented as proprietary funds. Proprietary funds also include internal service funds, which are used to report activity that provides goods or services on a cost reimbursement basis predominantly to the Authority/Corporation's other business-type activities. The Authority/Corporation follows all applicable GASB pronouncements.

Fiduciary activities include private-purpose trust and agency funds administered by the Authority/Corporation pursuant to FFELP, the Trust and the Plan. The fiduciary fund financial statements are comprised of a statement of net position and a statement of changes in fiduciary net position. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements reflect all of the assets, liabilities, revenues, expenses, gains and losses of the FSLRF, the Trust and the Plan.

The Authority/Corporation's Fiduciary Funds are held in a custodial capacity. FSLRF assets and all earnings on those assets are the property of the Federal government and are used primarily to facilitate FFELP claim payments. Assets of the Trust are held by the Authority/Corporation on behalf of program participants. Assets of the Plan are held by the Authority/Corporation to offset future tuition obligations.

Cash and Cash Equivalents - The Authority/Corporation considers cash and cash equivalents to include highly liquid investments, which mature within one month or less of purchase.

Investments - Investments for all funds consist primarily of securities of the federal government or its agencies, corporate bonds, commercial paper collateralized mortgage obligations and mutual funds, which are stated at fair market value. Fair market value is determined by using quoted market prices as of the last day of the fiscal year.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note B--Summary of Significant Accounting Policies--Continued

The Plan maintains a separate investment policy with the current following target asset allocation:

Large Cap U.S. stocks	30%
Mid Cap U.S. stocks	5%
Small Cap U.S. stocks	4%
Non-U.S. stocks	<u>9%</u>
Total Equity	<u><u>48%</u></u>
Inflation indexed bonds	7%
Domestic fixed income	44%
Cash	<u>1%</u>
Total Fixed Income	<u><u>52%</u></u>

To decrease overall investment risk, the following restrictions apply to the Plan's investments:

- i. No more than 5% of the total amount of the equity portion of the investment account in the securities of any one issuer;
- ii. No more than 25% of the total amount of the equity portion of the investment account in any one industry, as defined by Standard & Poor's;
- iii. For portfolios invested in major-market countries, no more than 25% of the total amount of the equity portion of the investment account in any one country with the exception of those countries whose weighting in the Europe, Australia, and Far East ("EAFE") index is greater than 25%, where a maximum weight of the current country weight in the EAFE benchmark plus 10% is permitted;
- iv. For portfolios invested in emerging markets, no more than 20% of the equity portion of the investment account shall be invested in one country;
- v. A minimum of eight countries shall be represented in each investment account; and
- vi. No more than 10% of the total amount of the fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States of America or AAA-related securities issued by government agencies as to which there is no limit.

Under the Kentucky Revised Statutes, the Authority/Corporation's Board of Directors is charged with selecting the various options in which the participants of the Trust can invest their funds. An individual participating in the Trust establishes an account in the name of a Beneficiary. Contributions currently can be made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, the Equity Index Option, the Active Equity Option and the Guaranteed Option.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note B--Summary of Significant Accounting Policies--Continued

Teacher and Osteopathic Medicine Scholarship Loan and Advances - Teacher Scholarship advances to students may be repaid via eligible service credits granted for specified teaching in primary or secondary schools. The disbursements are recorded as advances and charged to program benefits over the period that the teaching service is performed. If the teaching requirements are not satisfied, the advances are converted to loans, which are repayable with interest.

Osteopathic medicine scholarship advances to students may be repaid via eligible service credits granted for working as a doctor in Kentucky. The expenditures are recorded as advances and charged to program benefits over the period that the medical services are provided. If the medical requirements are not satisfied, the advances are converted to loans, which are repayable with interest.

Fixed Assets, Net - Fixed assets are stated at cost, less accumulated depreciation. Fixed assets are depreciated beginning when the assets are placed in service and continuing over the estimated useful lives of the respective asset using the straight-line method.

Defaulted Student Loans - All applicable collections on defaulted loans are recorded as income when received. The portion of collections due to the federal government is treated as a contra-revenue. Federal defaulted loans outstanding are accounted for by the Authority/Corporation but are not presented on the accompanying combined statement of net position.

Allowance for Uncollectible Loans - As discussed in Note A, most FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the ED. Management of the Authority/Corporation believes that all of its respective guaranty agencies and the ED will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan loss on all loans funded through normal operations was \$6.1 million for loan principal and \$638,000 for accrued interest as of June 30, 2018. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2018, the allowance for third party servicing loan losses for loans that have been purchased was \$1.4 million for loan principal and \$705,000 for accrued interest. In July 2015, the Authority/Corporation purchased an uninsured loan portfolio at a substantial discount. As of June 30, 2018, the allowance for the loans purchased at a discount was \$15.5 million for loan principal and \$5 million for accrued interest. In addition, the Authority/Corporation records a provision for loan loss related to Teacher and Osteopathic Medicine advances that have converted to loans. As of June 30, 2018, the allowance for advances converted to loans was \$3.2 million.

Pensions and OPEB - For purposes of measuring the net pension liability, the other postemployment benefit liability ("OPEB"), deferred outflows of resources and deferred inflows of resources related to pensions and OPEB and pension and OPEB expense, information about the fiduciary net position of the Kentucky Employees Retirement System ("KERS") and additions to/deductions from KERS' fiduciary net position have been determined on the same basis as they are reported by KERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note B--Summary of Significant Accounting Policies--Continued

Interest Income on Loans - The Authority/Corporation earns interest income on loans from the following three sources: (1) subsidized interest from ED earned while certain students are in school, in grace or in deferment status; (2) special allowance from ED (discussed in Note G); and (3) borrower interest. All interest is recorded when earned and is shown in the combined financial statements net of the interest related portion of the provision for loan losses and net of any negative special allowance owed to ED (discussed in Note G).

Servicing Fees - The Authority/Corporation's fees for servicing loans held by third parties are recorded as servicing fee revenue when earned.

Third party loans serviced by the Authority/Corporation are not presented on the combined statement of net position, as they are not owned by the Authority/Corporation.

Debt Issuance Costs - Debt issuance costs are expensed when incurred.

Deferred Gain on Early Retirement of Debt - In accordance with GASB No. 23, *Accounting and Financial Reporting of Debt Reported by Proprietary Activities*, and in accordance with GASB No. 63, *Financial Reporting of Deferred Outflows or Resources, Deferred Inflows of Resources and Net Position*, the Authority/Corporation defers any gains related to early retirement associated with a refinancing of debt over the shorter of the remaining life of the old debt or the life of the new debt.

Income Taxes - The Authority is a state government agency established by the Kentucky General Assembly and the Corporation is an independent *de jure* municipal corporation and political subdivision of the Commonwealth of Kentucky; therefore, they are not subject to federal or state income taxes. The Trust and the Plan are state sponsored IRC Section 529 education savings plans and are also not subject to federal or state income taxes.

Use of Estimates - Accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Interfund Eliminations - Interfund receivables and payables are eliminated in the governmental and business-type activities column of the combined government-wide statement of net position. Net residual amounts due between governmental and business-type activities are reflected as receivable (payable) for internal balances. Amounts reported in funds as receivable from or payables to fiduciary funds are reflected in the combined government-wide statement of net position. Eliminations are made in the combined government-wide statement of activities to remove the doubling-up effect of internal service fund activity.

Program Revenues - Program revenues are reported in two categories including (1) charges for services and (2) program-specific operating grants and contributions. Charges for services include revenues received in the form of fees and charges for the Authority/Corporation loan guarantee,

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note B--Summary of Significant Accounting Policies--Continued

default collection, interest income from the corporate loan finance and servicing activities, school services, and other activities.

Program-specific operating grants and contributions include revenues from mandatory and voluntary non-exchange transactions with other governments and organizations that are restricted for use in a particular program. Program-specific operating grant and contribution services include the interest earned on scholarship loans.

Contribution Receivable - As discussed in Note A, participants in the Plan may elect to make payments on executed tuition contracts over a specific period. Contributions receivable are recorded at their net realizable value in the period in which a tuition contract is purchased. A finance charge of 7.25% per annum of the outstanding balance is charged to participants who enrolled in the Plan during fiscal year 2005.

Tuition Benefits and Other Payable - Tuition benefits payable are reported at the actuarial net present value of estimated future benefits to be paid on behalf of participants of the Plan. The reported amount reflects actuarial assumptions, including anticipated tuition and fee increases, expected investment earnings, and refunds and other terminations.

Indirect Costs - Indirect costs are allocated among functions/programs utilizing a full cost allocation approach with the objective of allocating all expenses to the Authority/Corporation's various functions and programs.

Risk Management - The Authority/Corporation is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries. Coverage against various risks of loss is obtained through participation in the State of Kentucky's Risk Management Fund, State Sponsored Group Insurance Fund, and policies purchased from outside insurance corporations.

Restricted Net Position - Restricted net position is comprised of net position with legal or contractual restrictions and thus cannot be used in operations of the Authority/Corporation.

Unrestricted Net Position - Unrestricted net position is comprised of net position available to be used in operations or transfers of the Authority/Corporation. As of June 30, 2018, the Authority/Corporation's unrestricted net position is (\$57,590,161).

Subsequent Events - In preparing these combined financial statements, the Authority/Corporation has evaluated events and transactions for potential recognition or disclosure through the date of the Independent Auditors' Report, which represents the date the financial statements were available to be issued. See Note T.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note C--Cash and Investments

The Authority/Corporation has adopted provisions of GASB Statement No. 40, *Deposits and Investment Risk Disclosures*. This statement adds certain additional disclosures about cash and investments, including common areas of investment risk.

The Authority/Corporation's operating funds and investments comply with the Operating Funds Investment Policy. The policy permits investments in bank time deposits, certificates of deposit, commercial paper, agency mortgage-backed securities, asset-backed commercial paper, banker's acceptance and floating-rate notes with a coupon reset of 30 days or less, direct obligations of the United States of America (which are unconditionally guaranteed by the United States of America), indebtedness issued by certain Federal agencies, U.S. dollar denomination corporate bonds and obligations of foreign governments, asset-backed securities, and taxable and tax-exempt municipal bonds. All securities must have a minimum rating of investment grade BBB or better by a nationally recognized credit rating agency at the time of purchase. Money market instruments must be rated A-1 or P-1 or better at the time of purchase. An average rating of A must be maintained by the total portfolio.

The investments in the Authority/Corporation's Education Finance Funds comply with the underlying bond resolution and indenture requirements, as applicable. Additionally, such requirements mandate specific classes of investment vehicles including bank time deposits, certificates of deposit, direct obligations of the United States of America (which are unconditionally guaranteed by the United States of America), indebtedness issued by certain Federal agencies, collateralized repurchase agreements or investment funds secured by obligations of the United States of America with collateral held by or at the direction of the trustee.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note C--Cash and Investments--Continued

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2018, the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained cash on deposit as follows:

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
FDIC Insured		\$ 539,605	\$ 521,476
Uninsured		2,564,991	
Collateralized by securities held by the pledging financial institution		16,353,419	11,277,977
Money market demand deposits			
Money market securities		53,161,822	11,892,119
Cash deposited with Kentucky State Treasurer	<u>\$ 6,361,124</u>	<u>2,189,967</u>	<u>10,771</u>
	<u><u>\$ 6,361,124</u></u>	<u><u>\$ 74,809,804</u></u>	<u><u>\$ 23,702,343</u></u>

Of the \$74.8 million of cash and cash equivalents maintained in the Proprietary Funds, \$17.7 million was held for guarantee operations and the remaining \$57.1 million was held for loan finance and servicing activities.

Of the \$23.7 million of cash and cash equivalents maintained in the Fiduciary Funds, \$22.2 million was related to the FSLRF and the remaining \$1.5 million was associated with the Plan.

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note C--Cash and Investments--Continued

As of June 30, 2018, all Proprietary Fund investments were registered in the Authority/Corporation's name and maintained by an external trustee or investment manager, as applicable. The investment balances as of June 30, 2018 are summarized as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
Corporate bonds	\$ 52,664,515	2.64
U.S. Treasury and government agency securities	26,067,091	1.90
Collateralized mortgage obligations	<u>11,364,924</u>	11.22
	<u>\$ 90,096,530</u>	

As of June 30, 2018, Trust investments of \$211.9 million comprised entirely of TIAA mutual funds.

As of June 30, 2018, Plan investments of \$68.5 million comprised primarily of mutual funds held by State Street Global Advisors.

Investments are made based upon prevailing market conditions at the time of the transaction with the intent to hold the instrument until maturity. If the yield of the portfolio can be improved upon sale of an investment, prior to its maturity, with the reinvestment of proceeds, then this provision is also allowed.

Concentration of Credit Risk - The Authority/Corporation does not maintain investments in any one issuer that represents 5% or more of the total investment base, excluding investments issued or explicitly guaranteed by the U.S government and investments in mutual funds.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note C--Cash and Investments--Continued

Credit Risk - The Authority/Corporation's investment policy limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poor's / Moody's rating (as applicable) for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2018:

<u>Rating</u>	<u>Fair Value</u>
AAA / Aaa	\$ 21,637,599
AA / Aa	5,145,246
A / A	11,475,702
BAA / Baa	<u>14,405,968</u>
	<u>\$ 52,664,515</u>

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. No more than 10% of the total amount of fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States or AAA-rated securities issued by government agencies as to which there is no limit. The Plan may invest in short-term commercial paper of any domestic issuer, maturing within 9 months, with a minimum rating of A-1 by Standard & Poor's or Prime 1 by Moody's. As previously noted, at June 30, 2018, the Plan primarily invested in mutual funds.

Fair Value Measurement

In accordance with GASB 72, *Fair Value Measurement and Application*, the Authority/Corporation categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs; and Level 3 are significant unobservable inputs.

Level 1: Quoted prices (unadjusted) of identical assets or liabilities in active markets that an entity has the ability to access as of the measurement date, or observable inputs.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note C--Cash and Investments--Continued

Fair Value on a Recurring Basis

The Authority/Corporation has the following recurring fair value measurements as of June 30, 2018:

Money Market Securities of \$53,161,822 are valued using quoted market prices. (Level 1 Inputs).

Corporate bonds, U.S. Treasury and government agency securities, and collateralized mortgage obligations of \$90,096,530 were based on Level 2 inputs.

As of June 30, 2018, 100% of the value of the Trust and Plan investments was based on Level 1 inputs.

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2017	Additions	Disposals	Ending Balance June 30, 2018
Proprietary fund:				
Furniture and equipment	\$ 14,210,003	\$ 475,031	\$ 142,277	\$ 14,542,757
Building	12,075,049			12,075,049
System development	55,955			55,955
Student loan servicing system	541,131			541,131
Debt recovery system	81,047			81,047
Accumulated depreciation and amortization	<u>(19,409,532)</u>	<u>(1,060,769)</u>	<u>(142,277)</u>	<u>(20,328,024)</u>
	<u>\$ 7,553,653</u>	<u>\$ (585,738)</u>	<u>\$</u>	<u>\$ 6,967,915</u>
Fiduciary Fund:				
Furniture and equipment	\$ 67,688	\$	\$	\$ 67,688
Accumulated depreciation	<u>(67,688)</u>			<u>(67,688)</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

Depreciation and amortization expense totaled \$1,060,769 for the year ended June 30, 2018, of which \$927,533 was allocated to business-type activities, \$126,621 allocated to governmental activities, and \$6,615 allocated to the fiduciary activities.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note D--Fixed Assets--Continued

Depreciation and amortization expense was allocated to the business-type activities functions as follows:

Loan guarantee operations	\$	318,944
Outreach		196,597
School services		42,031
Default collections		108,016
Loan finance and servicing		<u>261,945</u>
	<u>\$</u>	<u>927,533</u>

The Authority/Corporation has assets under capital lease agreements, as described in Note I, of \$12,075,049 with related accumulated amortization of \$6,097,274. Amortization of assets under capital lease is included in amortization expense in the accompanying combined financial statements. Amortization expense of assets under capital lease agreements was \$402,502 for the year ended June 30, 2018.

Note E--Federal Family Education Loan Programs (Loan Guarantee Operations)

Pursuant to FFELP, the loan guarantee operating unit of the Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2018, the outstanding balance of aggregate insured student loans was approximately \$1.59 billion.

Loans insured by the Authority/Corporation are reinsured under FFELP by the federal government. Death, disability, bankruptcy, lender of last resort, closed school, false certification, and ineligible borrower claims are reinsured at 100%. Default claims are subject to the Authority/Corporation's default claims rate (reimbursed default claims for the federal fiscal year divided by the original principal amount of loans in repayment at the beginning of the fiscal year).

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. 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%. Therefore, the Authority/Corporation has not recorded a reserve at June 30, 2018 for losses on federal reinsurance. See Footnote R.

The Authority/Corporation is entitled to charge certain fees associated with its reinsurance activities. A summary of those fees are as follows:

Rehabilitated Loans - The Authority/Corporation was entitled to retain 18.5% of principal and all accrued interest for rehabilitated loans, plus 18.5% of collection costs through June 30, 2014. Effective July 1, 2014, 100% of principal is paid to ED and the Authority/Corporation is entitled to retain all accrued interest for rehabilitated loans plus 16% of collection costs.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note E--Federal Family Education Loan Programs (Loan Guarantee Operations)--Continued

Consolidated Loans - For William D. Ford Consolidation, the Authority/Corporation is entitled to 10% collection costs (18.5% collected, less 8.5% rebate to ED).

Recoveries Payable to Federal Government - The Authority/Corporation is entitled to retain 16% of defaulted loan collections received after October 1, 2007.

Account Maintenance Fees ("AMF") - The 1998 Amendments established an account maintenance fee based on 0.06% of the sum of net guarantees as of September 30. AMF is paid to the Authority/Corporation on a quarterly basis by the Federal government.

Default Aversion Fees ("DAF") - Default aversion fees were established under the 1998 Amendments. The Authority/Corporation receives DAF for its aversion activities on delinquent loans at the time lenders request default aversion assistance. DAF are equal to 1% of principal and interest on the loan at the time the Authority/Corporation receives a request from a lender for preclaim assistance. DAF are recorded monthly and are recognized as a deduction in the FSLRF and as revenue in the AOF. DAF are remitted back to the FSLRF for loans that default.

Note F--Loans (Finance and Servicing Operations)

The Authority/Corporation originates private supplemental loans, purchases loans and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of generally ten years with most FFELP consolidation loans and many Advantage refinance loans having longer repayment terms. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 1.9% to 12% for the fiscal year ended June 30, 2018 depending upon the type and date of origination of the individual loan. Actual rates may be lower due to interest rate reductions associated with payments via electronic funds transfer or for other reasons such as borrowers making a specified number of consecutive on-time payments.

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note F--Loans (Finance and Servicing Operations)--Continued

Loans consist of the following at June 30, 2018:

Stafford - Subsidized	\$ 245,009,193
Stafford - Unsubsidized	281,690,704
PLUS/SLS	16,148,352
Consolidation	330,263,239
Supplemental	101,992,354
Other	<u>11,114,120</u>
Total gross loans	986,217,962
Allowance for loan losses	(22,997,815)
Unamortized discount on purchase of loans	<u>(826,468)</u>
Loans, net	962,393,679
Less amount shown as current assets	<u>152,099,499</u>
Noncurrent loans, net	<u>\$ 810,294,180</u>

All principal and accrued interest on FFELP student loans is insured against borrower death, disability, bankruptcy or default, as long as the Authority/Corporation performs all required loan servicing due diligence activities. In July 2015, the Authority/Corporation purchased an uninsured loan portfolio at a substantial discount. As of June 30, 2018, the allowance for the loan principal purchased at a discount was \$15.5 million. In addition, \$2,255,650 of student loan principal was no longer insured due to violations of due diligence requirements.

All student loans in the Education Finance Funds and some student loans of the Corporation Operating Fund are pledged as collateral for certain bonds and lines of credit payable.

Note G--Special Allowance

The Higher Education Act of 1965 provides for quarterly Special Allowance Payments to be made by ED to holders of student loans to the extent necessary to ensure that they receive at least specified market interest rates of return. Certain FFELP loans disbursed during the period from January 1, 2000 through June 30, 2010 received special allowance at a rate based upon the average of the bond equivalent rates of the three-month commercial paper rate as reported by the U.S. Federal Reserve through March 31, 2012. Pursuant to a December 23, 2011, amendment to the Higher Education Act, the Authority/Corporation elected to change the index for special allowance calculations on its FFELP loans disbursed after January 1, 2000, from the three-month commercial paper (CP) rate to the one-month LIBOR index beginning on April 1, 2012. Other eligible loans receive special allowance based on the 91-day Treasury bill rates. The special allowance is accrued as either earned or payable, as applicable.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note H--Loan and Other Forgiveness

During fiscal year 2018, the Authority/Corporation forgave approximately \$1.2 million in loan principal and accrued interest for teachers funded by ED, and an additional \$1.4 million in loan forgiveness for teachers funded by the Commonwealth of Kentucky. Also, during fiscal year 2018, the Authority/Corporation provided additional loan forgiveness of \$215,249.

Note I--Capital Lease Payable

On June 22, 2000, the Commonwealth of Kentucky, State Property and Building Commission (the "Commission") issued \$8,825,000 in bonds payable on behalf of the Authority/Corporation. The proceeds of the bonds are used to house the Authority/Corporation's operations located in Frankfort, Kentucky. On October 8, 2003, the Commission issued additional bonds payable on behalf of the Authority/Corporation as a partial refunding of original bonds payable.

The original bonds had a final principal payment in May 2010. The new bonds bear interest at fixed rates which vary from 2.0% to 5.25% and have a maturity date of May 2020. The bonds are special and limited obligations of the Commission. The bonds do not constitute a debt, liability or obligation of the Commonwealth of Kentucky or a pledge of the full faith and credit or taxing power of the Commonwealth of Kentucky, but are payable solely from amounts derived from the biennially renewable lease agreement with the Authority/Corporation as described below. The bondholders have no security interest in any properties constituting the project or any amounts derived there from.

The scheduled payments of principal and interest on the bonds are guaranteed under an insurance policy.

In connection with the issuance of the bonds, the Authority/Corporation entered into a financing/lease agreement with the Commission whereby the Authority/Corporation agreed to lease the newly constructed building. The Authority/Corporation renewed the lease for the biennium ending June 30, 2020.

The Authority/Corporation can cancel the lease on the last business day in May immediately preceding the beginning of any renewal term.

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the Kentucky General Assembly appropriated sufficient spending authorization to the Authority/Corporation to pay the lease payments required through June 30, 2020.

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note I--Capital Lease Payable--Continued

A summary of the activity for the capital lease for the year ended June 30, 2018 is as follows:

	<u>June 30, 2017</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2018</u>
Capital Lease Payable	<u>\$ 2,020,000</u>	<u>\$</u>	<u>\$ 640,000</u>	<u>\$ 1,380,000</u>

Debt service requirements for the final two fiscal years are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2019	\$ 670,000	\$ 72,013
2020	<u>710,000</u>	<u>37,275</u>
	<u>\$ 1,380,000</u>	<u>\$ 109,288</u>

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note J--Revenue Bonds and Notes Payable

The balance of revenue bonds and notes payable at June 30, 2018 and the related activity for the year ended June 30, 2018 is as follows:

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest</u>	<u>Beginning Balance July 1, 2017</u>	<u>Bond Refundings</u>	<u>New Issues</u>	<u>Amortization of Premium / (Discount) June 30, 2018</u>	<u>Ending Balance June 30, 2018</u>
<u>2008 Indenture</u>							
2008 A-1	* June 1, 2037	Weekly	\$ 71,420,000	\$ (71,420,000)			
2008 A-2	* June 1, 2038	Weekly	<u>51,325,000</u>	<u>(51,325,000)</u>			
			<u>122,745,000</u>	<u>(122,745,000)</u>			
<u>2010 Indenture</u>							
2010 A-1	* May 1, 2020	Quarterly	<u>94,190,000</u>	<u>(9,945,000)</u>			<u>\$ 84,245,000</u>
2010 A-2	* May 1, 2034	Quarterly	<u>94,190,000</u>	<u>(9,945,000)</u>			<u>84,245,000</u>
<u>2013-1 Indenture</u>							
2013-1	June 1, 2026	Monthly	<u>247,185,000</u>	<u>(42,200,000)</u>			<u>204,985,000</u>
<u>2013-2 Indenture</u>							
2013-2	June 1, 2028	Monthly	<u>201,919,167</u>	<u>(33,700,000)</u>		<u>\$ 174,612</u>	<u>168,393,779</u>
<u>2014 Indenture</u>							
2014 A	* June 1, 2031	Fixed	<u>15,286,619</u>	<u>(2,510,000)</u>		<u>(91,899)</u>	<u>12,684,720</u>
2017 A	* June 1, 2034	Fixed	<u>41,076,155</u>	<u>(2,475,000)</u>		<u>(255,719)</u>	<u>38,345,436</u>
			<u>56,362,774</u>	<u>(4,985,000)</u>		<u>(347,618)</u>	<u>51,030,156</u>
<u>2015-1 Indenture</u>							
2015-1	December 1, 2031	Monthly	<u>87,145,000</u>	<u>(12,489,000)</u>			<u>74,656,000</u>
<u>2016-1 Indenture</u>							
2016-1-1-A & B	* June 1, 2026	Monthly	<u>45,356,180</u>	<u>(6,555,000)</u>			<u>38,801,180</u>
2016-1-2-A & B	June 1, 2026	Monthly	<u>33,107,310</u>	<u>(5,895,000)</u>			<u>27,212,310</u>
			<u>78,463,490</u>	<u>(12,450,000)</u>			<u>66,013,490</u>
<u>2017-1 Indenture</u>							
2017-1	December 1, 2037	Monthly		<u>(5,035,000)</u>	<u>\$ 171,068,000</u>		<u>166,033,000</u>
			<u>\$ 888,010,431</u>	<u>\$ (243,549,000)</u>	<u>\$ 171,068,000</u>	<u>\$ (173,006)</u>	<u>\$ 815,356,425</u>

* This bond series is tax exempt

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note J--Revenue Bonds and Notes Payable--Continued

The Authority/Corporation's revenue bonds include fixed and variable rates of interest based on various index rates. Those fixed rates and variable index rates ranged from 0.70% to 5.0% as of June 30, 2018.

Debt service requirements to maturity or redemption date, assuming interest rates based on fixed rates and variable index rates at June 30, 2018, are as follows:

	Principal Repayment Amount (Thousands)							Total
	2010	2013-1	2013-2	2014	2015-1	2016-1	2017-1	
Year Ending June 30, 2019				\$ 2,610				\$ 2,610
1 Years Ending June 30, 2020				2,690				2,690
5 Years Ending June 30, 2025				13,780				13,780
5 Years Ending June 30, 2030		\$ 204,985	\$ 170,169	18,505		\$ 66,013		459,672
5 Years Ending June 30, 2035	\$ 84,245			12,465	\$ 74,656			171,366
3 Years Ending June 30, 2038							\$ 166,033	166,033
	<u>\$ 84,245</u>	<u>\$ 204,985</u>	<u>\$ 170,169</u>	<u>\$ 50,050</u>	<u>\$ 74,656</u>	<u>\$ 66,013</u>	<u>\$ 166,033</u>	<u>\$ 816,151</u>

	Interest Repayment Amount (Thousands)							Total
	2010	2013-1	2013-2	2014	2015-1	2016-1	2017-1	
Year Ending June 30, 2019	\$ 2,998	\$ 5,314	\$ 4,581	\$ 2,070	\$ 2,122	\$ 2,071	\$ 2,010	\$ 21,166
Year Ending June 30, 2020	2,998	5,314	4,581	1,964	2,122	2,071	2,010	21,060
Year Ending June 30, 2021	2,998	5,314	4,581	1,830	2,122	2,070	2,010	20,925
Year Ending June 30, 2022	2,998	5,313	4,581	1,690	2,122	2,070	2,010	20,784
Year Ending June 30, 2023	2,997	5,313	4,581	1,540	2,122	2,070	2,010	20,633
5 Years Ending June 30, 2028	14,987	15,940	22,906	5,761	10,609	6,212	10,049	86,464
5 Years Ending June 30, 2033	14,987			2,278	6,365		10,049	33,679
5 Years Ending June 30, 2038	2,997			215			8,039	11,251
	<u>\$ 47,960</u>	<u>\$ 42,508</u>	<u>\$ 45,811</u>	<u>\$ 17,348</u>	<u>\$ 27,584</u>	<u>\$ 16,564</u>	<u>\$ 38,187</u>	<u>\$ 235,962</u>

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note J--Revenue Bonds and Notes Payable--Continued

All assets of the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 Indenture, and the 2017 Indenture are pledged for repayment of the specific bond or note issues under each resolution or program.

Note K--Line of Credit

On September 12, 2017, the Authority/Corporation executed a new Warehouse Loan and Security Agreement and Amendment to Loan Documents with a commercial bank (the "Bank") to provide up to \$45,000,000 for each of the two Lines of Credit for a total of \$90,000,000. One Line of Credit is a revolving Line of Credit with a three-year term period. Cash and marketable securities of the Operating Funds of the Authority/Corporation are pledged as collateral against any outstanding balance on the \$45,000,000 Line of Credit. The second \$45,000,000 Line of Credit is a multi-draw term loan ("Credit Facility") with an 18-month period for advances on the Credit Facility followed by a one-year term loan. The Credit Facility is restricted to the acquisition of loans made through FFELP and is collateralized by the loans financed with funds advanced by the Bank. In addition, both Lines of Credit will also be cross-collateralized. The outstanding balances on the revolving Line of Credit and the Credit Facility as of June 30, 2018 were approximately \$33.3 million and \$27.2 million, respectively.

Note L--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, may be satisfied in three ways (1) yield adjustment payments with respect to (a) non-purpose obligations allocated to bonds issued on a variable rate basis, and (b) purpose obligations that were acquired after July 18, 2016 or that were acquired prior to such date if allocated to tax exempt bonds bearing interest on a variable rate basis or to tax exempt bonds issued primarily to finance Federal Family Education Loan Program loans, (2) loan forgiveness, and (3) arbitrage rebate. At June 30, 2018, the Authority/Corporation is reporting a liability for excess yield on acquired purpose investments of \$369,490.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note L--Allowance for Arbitrage Liabilities--Continued

The determination of excess yield on acquired purpose investments is cumulative over the life of the applicable bond series, as is the determination of arbitrage rebate on non-purpose investments, except for variable rate bonds for which arbitrage rebate is generally determined for each five-year period without retroactivity.

Yield adjustment payments, which also relate to yield restriction on acquired purpose investments, are applicable to all tax exempt bonds with respect to such investments that were acquired after July 18, 2016 and also apply to such investments that were acquired prior to such date if allocated to tax exempt bonds bearing interest on variable rate basis or to tax exempt bonds issued primarily to finance Federal Family Education Loan Program loans. The allowable yield is 2% above the bond yield (arbitrage yield), with the federal special allowance included in income. The loss of tax exempt status may be avoided by rebating 75% of the excess yield to the US treasury at least once every five years subsequent to the 10th anniversary date of the issuance and the full amount upon final maturity of the bonds.

Forgiveness is applicable to all tax exempt bonds. In general, a yield restriction is imposed on acquired purpose investments, designating the allowable yield as 2% above the bond yield (arbitrage yield). The loss of tax-exempt status may be avoided by partial forgiveness of the applicable student loans. Forgiveness can be applied upon maturity of the bonds or as otherwise prescribed by the bond resolutions.

On May 6, 2013, the Corporation entered into a voluntary closing agreement (the "VCA") with the Internal Revenue Service (the "IRS") relating to certain of its tax-exempt bonds (collectively, the "Subject Bond Issues"). The VCA resulted from a request that was submitted by KHESLC on July 31, 2012 pursuant to IRS Announcement 2012-14, 2012-14 I.R.B. 721, titled TEB Voluntary Closing Agreement Program: Relief from Allocation and Accounting Errors for Certain Issuers of Tax-Exempt Student Loan Bonds (the "Announcement"). The VCA modified the application of the foregoing excess yield discussion with respect to the Subject Bond Issues. The determination of excess yield on acquired purpose investments is no longer applicable for the Subject Bond Issues.

Arbitrage rebate is applicable to all of the Authority/Corporation's tax-exempt bonds. With certain limited exceptions, income earned on non-purpose investments (investments other than student loans) which exceeds the bond yield (arbitrage yield), must be rebated to the U.S. Treasury. Payments of at least 90% are due every five years after the year of issuance, and upon final maturity of bonds.

Note M--Deferred Gain on Retirement of Debt

In fiscal year 2010, the Authority/Corporation purchased \$1.198 billion of its own auction rate securities and retired the debt. The resulting \$80.2 million of gain was deferred and is being amortized over the life of the new debt. In addition in fiscal year 2014, the Authority/Corporation purchased \$358.65 million of its own auction rate securities and retired the debt. This resulted in an additional \$7.2 million of gain which was deferred and is being amortized over the remaining life of the old debt. The Authority/Corporation recognized a gain of \$1.8 million for the year ended June 30, 2018. As of June 30, 2018, there is \$14.6 million of gain remaining to be amortized.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability

Plan Description. Employees of the Authority/Corporation participate in Kentucky Employees Retirement systems ("KERS"), a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems ("KRS"). KRS is governed by Kentucky Revised Statutes 61.510 through 61.705 and can only be modified by the state legislature.

Benefits Provided. KERS provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

All regular full-time employees of the Authority/Corporation are covered by KERS. A regular full-time employee is an employee that averages one hundred or more hours per month over a calendar or fiscal year. KERS consist of three tiers:

- Tier 1: Participation prior to September 1, 2008
- Tier 2: Participation on or after September 1, 2008 to December 31, 2013
- Tier 3: Participation on or after January 1, 2014

For Tiers 1 and 2, the benefit paid is based on the following formula: Final Compensation X Benefit Factor X Years of Service = Annual Benefit. For Tier 3, the benefit paid is based on the member's accumulated account balance at the time of retirement.

In 2013, all Cost of Living Adjustments ("COLA's") were eliminated unless the State Legislature so authorizes on a biennial basis and either (1) the system is over 100% funded or (2) the Legislature appropriates sufficient funds to prepay the increased liability for the COLA.

Contributions. Kentucky statutes set the rates for employer and employee contributions. Contributions rates can only be modified by the state legislature.

The employer and each employee contribute a percentage of the employee's creditable compensation. Creditable compensation consists of all wages includable on the employee's Federal Form W-2, Wage and Tax statement, under the heading "Wages, Tips, and Other Compensation". There are two exceptions of payment of wages not included in creditable compensation: (1) the lump-sum compensatory leave payments to employees in Tier 2 and 3 and (2) vacation payout at termination. The employer total contribution rate for FY18 was 49.47% comprised of 41.06% for pension contributions and 8.41% for insurance contributions and FY17 was 48.59% comprised of 40.24% for pension contributions and 8.35% for insurance contributions. The employee's contribution rates are as follows: Tier 1 - 5%, Tier 2 and 3 - 6%.

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability--Continued

The contributions for the employer and employee are as follows:

	<u>FY18</u>	<u>FY17</u>
Authority: Employer	\$ 477,778	\$ 542,195
Authority: Employee	48,223	65,425
	<u>\$ 526,001</u>	<u>\$ 607,620</u>
Corporation: Employer	\$ 5,441,929	\$ 5,177,378
Corporation: Employee	688,923	680,160
	<u>\$ 6,130,852</u>	<u>\$ 5,857,538</u>
Total: Employer	\$ 5,919,707	\$ 5,719,573
Total: Employee	737,146	745,585
	<u>\$ 6,656,853</u>	<u>\$ 6,465,158</u>

The employer is responsible for additional contributions if pension spiking occurs. Pension spiking may be deemed to have occurred for certain large compensation increases in the five years immediately preceding retirement. Kentucky Revised Statute 61.598 requires the last participating employer, for employees retiring on or after January 1, 2014 to June 1, 2017, to pay for any additional actuarial costs resulting from annual increases in an employee's creditable compensation greater than ten percent over the employee's last five fiscal years of employment that are not a direct result of a bona fide promotion or career advancement. For employees retiring January 1, 2018 and thereafter, the employees retirement benefit will be reduced for the pension spiking and the employer is no longer liable.

Pension Costs. At June 30, 2018, the Authority/Corporation reported a net pension liability of \$123,006,949 for its proportionate share of the KERS's collective net pension liability. The Authority's portion is \$11,405,792 and the Corporation's is \$111,601,157. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by the actuarial valuation as of that date. The Authority/Corporation's estimated proportionate share of the collective net pension liability was based on a projection of the Authority/Corporation's long-term share of contributions to the pension plan relative to the projected contributions of all employer participants, as actuarially determined. The Authority's contributions during the measurement period as provided by KRS were \$530,040 with a proportionate share percentage of .085192%. The Corporation's contributions during the measurement period as provided by KRS were \$5,186,253 with a proportionate share percentage of .833570%.

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability--Continued

For the year ended June 30, 2018, the Authority/Corporation recognized pension expense of \$19,315,485 for its proportionate share of KERS's pension expense. The Authority's portion was \$1,214,676 and the Corporation's was \$18,100,809.

At June 30, 2018, the Authority reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

<u>Authority</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience	\$ 2,029	\$ 73,448
Net difference between projected and actual investment earnings on pension plan investments	142,543	87,387
Changes in assumptions	1,447,100	
Changes in proportion and differences between employer contributions and proportionate share of contributions		768,737
Authority's contributions to KERS subsequent to the measurement date	477,778	
	<u>\$ 2,069,450</u>	<u>\$ 929,572</u>

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability--Continued

\$477,778 reported as deferred outflows of resources related to pensions resulting from the Authority's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2019. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Authority Deferred Outflows of Resources

<u>Original Deferral Year</u>	<u>Original Deferral Amount</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
2015	\$ 515,941	\$ (128,985)	\$ (128,985)	\$ (128,985)	\$ (128,986)		
2016	595,650		(148,913)	(148,913)	(148,913)	\$ (148,911)	
2017	886,964			(221,741)	(221,741)	(221,741)	\$ (221,741)
	<u>\$ 1,998,555</u>	<u>\$ (128,985)</u>	<u>\$ (277,898)</u>	<u>\$ (499,639)</u>	<u>\$ (499,640)</u>	<u>\$ (370,652)</u>	<u>\$ (221,741)</u>

Amortization 2018 \$ 277,898

Unamortized Amount 2018 \$ 1,591,672

Authority Deferred Inflows of Resources

<u>Original Deferral Year</u>	<u>Original Deferral Amount</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
2014	\$ 117,000	\$ (29,250)	\$ (29,250)	\$ (29,250)	\$ (29,250)			
2015	174,511		(43,628)	(43,628)	(43,628)	\$ (43,627)		
2016	200,939			(50,235)	(50,235)	(50,235)	\$ (50,234)	
2017	662,363				(165,591)	(165,591)	(165,591)	\$ (165,590)
	<u>\$ 1,154,813</u>	<u>\$ (29,250)</u>	<u>\$ (72,878)</u>	<u>\$ (123,113)</u>	<u>\$ (288,704)</u>	<u>\$ (259,453)</u>	<u>\$ (215,825)</u>	<u>\$ (165,590)</u>

Amortization 2018 \$ 123,113

Unamortized Amount 2018 \$ 929,572

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability--Continued

At June 30, 2018, the Corporation reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

<u>Corporation</u>	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 19,850	\$ 718,659
Net difference between projected and actual investment earnings on pension plan investments	1,394,724	855,051
Changes in assumptions	14,159,303	
Changes in proportion and differences between employer contributions and proportionate share of contributions	851,927	801,690
Corporation's contributions to KERS subsequent to the measurement date	5,441,929	
	<u>\$ 21,867,733</u>	<u>\$ 2,375,400</u>

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability--Continued

\$5,441,929 reported as deferred outflows of resources related to pensions resulting from the Corporation's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2019. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Corporation Deferred Outflows of Resources

Original Deferral Year	Original Deferral Amount	2017	2018	2019	2020	2021	2022
2015	\$ 7,181,849	\$(1,795,462)	\$(1,795,462)	\$(1,795,462)	\$(1,795,463)		
2016	4,731,726		(1,182,932)	(1,182,932)	(1,182,932)	\$(1,182,930)	
2016	9,286,085			(2,321,521)	(2,321,521)	(2,321,521)	\$(2,321,522)
	<u>\$21,199,660</u>	<u>\$(1,795,462)</u>	<u>\$(2,978,394)</u>	<u>\$(5,299,915)</u>	<u>\$(5,299,916)</u>	<u>\$(3,504,451)</u>	<u>\$(2,321,522)</u>
Amortization 2018							<u>\$ 2,978,394</u>
Unamortized Amount 2018							<u>\$ 16,425,804</u>

Corporation Deferred Inflows of Resources

Original Deferral Year	Original Deferral Amount	2016	2017	2018	2019	2020	2021	2022
2014	\$ 918,000	\$(229,500)	\$(229,500)	\$(229,500)	\$(229,500)			
2015	(688,500)		172,125	172,125	172,125	\$ 172,125		
2016	1,427,639			(356,910)	(356,910)	(356,910)	\$(356,909)	
2017	1,419,421				(354,855)	(354,855)	(354,855)	\$(354,856)
	<u>\$ 3,076,560</u>	<u>\$(229,500)</u>	<u>\$(57,375)</u>	<u>\$(414,285)</u>	<u>\$(769,140)</u>	<u>\$(539,640)</u>	<u>\$(711,764)</u>	<u>\$(354,856)</u>
Amortization 2018								<u>\$ 414,285</u>
Unamortized Amount 2018								<u>\$ 2,375,400</u>

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note N--Net Pension Liability--Continued

Actuarial Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2017, using the entry age normal cost method and the following actuarial assumptions:

<u>Assumptions</u>	<u>Percentage</u>
Inflation	2.30% per year
Active Member Payroll Growth	0.00% per year
Investment Rate of Return	5.25% per year

Salary increases were based on a service-related table.

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (setback one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (setback four years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2017 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013. The Kentucky Retirement systems Board of Directors lowered three actuarial assumptions in May 2017. The inflation rate was lowered from 3.25% to 2.3%, the active member payroll growth was lowered from 4% to 0%, and the investment rate of return was lowered from 6.75% to 5.25%.

The long-term expected rate of return was determined by using a building-block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage.

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note N--Net Pension Liability--Continued

The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long Term Expected Real Rate of Return	Target Allocation
U.S. Equity	5.75%	17.50%
International Equity	7.38%	17.50%
Global Bonds	2.63%	10.00%
Global Credit	3.63%	17.00%
High Yield	5.75%	0.00%
Emerging Market Debt	5.50%	0.00%
Private Credit	8.75%	0.00%
Real Estate	6.63%	5.00%
Absolute Return	5.63%	10.00%
Real Return	5.13%	10.00%
Private Equity	8.25%	10.00%
Cash	1.88%	3.00%
		100.00%

The long-term expected rate of return on plan assets is 5.25%, which was established by the Board of Trustees of the Kentucky Retirement Systems based on a blending of the factors described above.

Discount Rate. The discount rate used to measure the total pension liability was 5.25%. The projection of cash flows used to determine the discount rate assumed employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26 year amortization period of the unfunded actuarial accrued liability.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note N--Net Pension Liability--Continued

Pension Liability Sensitivity. The following table presents the Authority/Corporation's proportionate share of the net pension liability in KRS, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Authority/Corporation's proportionate share of the net pension liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	<u>1% Decrease in Discount Rate</u>	<u>Discount Rate</u>	<u>1% Increase in Discount Rate</u>
KRS Discount Rate	4.25%	5.25%	6.25%
Authority's proportionate share of net pension liability	\$ 13,022,828	\$ 11,405,792	\$ 10,061,306
Corporation's proportionate share of net pension liability	\$ 127,423,217	\$ 111,601,157	\$ 98,445,895

Pension Plan Fiduciary Net Position. Detailed information about KERS's fiduciary net position is available in a KRS financial report. That report may be obtained on the Internet at www.kyret.ky.gov; by writing to Kentucky Retirement Systems at Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601; or by calling 1-800-928-4646.

Note O--Other Post-Employment Benefits ("OPEB")

Plan Description. Employees of the Authority/Corporation participate in Kentucky Employees Retirement systems ("KERS"), a cost-sharing multiple-employer defined benefit retiree healthcare plan (Insurance Fund) administered by Kentucky Retirement Systems ("KRS"). KRS is governed by Kentucky Revised Statutes 61.510 through 61.705 and can only be modified by the state legislature.

Benefits Provided. The Insurance Fund provides hospital and medical insurance for eligible retirees. Benefit provisions are established by state statute and can only be modified by the state legislature. The plan provides the following benefits based on the employees starting participation date:

- Participation prior to July 1, 2003 - The Insurance Fund contributes a percentage of a single monthly plan based on years of service and are as follows:

<u>Years of Service</u>	<u>Paid by Insurance Fund (%)</u>
20+ years	100.00%
15-19 years	75.00%
10-14 years	50.00%
4-9 years	25.00%
Less than 4 years	0.00%

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June 30, 2018

Note O--Other Post-Employment Benefits ("OPEB")--Continued

- Participation on or after July 1, 2003 and before September 1, 2008 – Once employees reach a minimum vesting period of 10 years, they earn \$10 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually, which is currently 1.50% based upon Kentucky Revenue Statutes
- Participation on or after September 1, 2008 – Once employees reach a minimum vesting period of 15 years, they earn \$10 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually, which is currently 1.50% based upon Kentucky Revenue Statutes.

Contributions. Contribution percentages are established in state statutes by the Kentucky Legislature. The contribution is a percentage of the employee's creditable compensation. The employer total contribution rate for FY18 was 49.47% comprised of 41.06% for pension contributions and 8.41% for insurance contributions. For FY18, the Authority/Corporation contributed \$1,212,787. Employees participating on or after September 1, 2008 are required to pay an additional 1% of their credible compensation for health insurance benefits. For FY18, employees contributed \$40,231.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB. At June 30, 2018, the Authority/Corporation reported a liability of \$23,299,457 for its proportionate share of the KERS's collective net OPEB liability. The Authority's portion is \$2,160,437 and the Corporation's is \$21,139,020. The net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by the actuarial valuation as of that date. The Authority/Corporation's proportionate share of the net OPEB liability was determined using the employers' actual contributions for FY17. The Authority's contributions during the measurement period as provided by KRS were \$109,986 with a proportionate share percentage of .085192%. The Corporation's contributions during the measurement period as provided by KRS were \$1,076,173 with a proportionate share percentage of .833570%.

For the year ended June 30, 2018, the Authority/Corporation recognized OPEB expense of \$2,129,893 for its proportionate share of KERS's OPEB expense. The Authority's portion was \$197,494 and the Corporation's was \$1,932,399.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note O--Other Post-Employment Benefits ("OPEB")--Continued

The fully-insured premiums KRS pays for KERS Insurance Fund are blended rates based on the combined experience of active and retired members. Because the average cost of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees, there is an implicit employer subsidy for the non-Medicare eligible retirees. The Authority/Corporation is required to include the liability associated with this implicit subsidy in the deferred outflows and calculation of the total OPEB liability. At June 30, 2018, the Authority/Corporation reported as part of the deferred outflow an implicit subsidy of \$181,433. The Authority's portion is \$16,823 and the Corporation's is \$164,610. At June 30, 2018, the Authority/Corporation reported as part of the OPEB expense an implicit subsidy of \$94,453. The Authority's portion is \$8,758 and the Corporation's is \$85,695.

At June 30, 2018, the Authority reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources related to OPEB, and its contributions subsequent to the measurement date, from the following sources:

<u>Authority</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience		\$ 2,673
Net difference between projected and actual investment earnings on pension plan investments		27,963
Changes in assumptions	\$ 282,866	
Changes in proportion and differences between employer contributions and proportionate share of contributions		15,855
Authority's implicit subsidy to KERS subsequent to the measurement date	16,823	
Authority's contributions to KERS subsequent to the measurement date	97,859	
	<u>\$ 397,548</u>	<u>\$ 46,491</u>

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note O--Other Post-Employment Benefits ("OPEB")--Continued

\$97,859 reported as deferred outflows of resources related to OPEB resulting from the Authority's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the year ended June 30, 2019. Amounts reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense as follows:

<u>Year Ending June 30:</u>	
2019	\$ 58,929
2020	58,929
2021	58,929
2022	659
Thereafter	

At June 30, 2018, the Corporation reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources related to OPEB, and its contributions subsequent to the measurement date, from the following sources:

Corporation	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience		\$ 26,159
Net difference between projected and actual investment earnings on pension plan investments		273,603
Changes in assumptions	\$ 2,767,736	
Changes in proportion and differences between employer contributions and proportionate share of contributions		155,132
Corporation's implicit subsidy to KERS subsequent to the measurement date	164,610	
Corporation's contributions to KERS subsequent to the measurement date	1,114,628	
	\$ 4,046,974	\$ 454,894

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note O--Other Post-Employment Benefits (“OPEB”)--Continued

\$1,114,628 reported as deferred outflows of resources related to OPEB resulting from the Corporation’s contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2019. Other amounts reported as deferred outflows and inflows of resources related to KERS OPEB will be recognized in OPEB expense as follows:

<u>Year Ending June 30:</u>	
2019	\$ 576,598
2020	576,598
2021	576,598
2022	6,450
Thereafter	

Actuarial Assumptions. The total OPEB liability was determined by an actuarial valuation as of June 30, 2017, using the entry age normal cost method and the following actuarial assumptions:

<u>Assumptions</u>	<u>Percentage</u>
Inflation	2.30%
Payroll Growth	0.00%
Investment Rate of Return	6.25%

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (setback one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (setback four years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2017, valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013. The Kentucky Retirement systems Board of Directors lowered three actuarial assumptions in May 2017. The inflation rate was lowered from 3.25% to 2.3%, the active member payroll growth was lowered from 4% to 0%, and the investment rate of return was lowered from 7.50% to 6.25%.

The long-term expected rate of return was determined by using a building-block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note O--Other Post-Employment Benefits (“OPEB”)--Continued

The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Long Term Expected Real Rate of Return</u>	<u>Target Allocation</u>
U.S. Equity	5.97%	17.50%
International Equity	7.85%	17.50%
Global Bonds	2.63%	4.00%
Global Credit	3.63%	2.00%
High Yield	5.75%	7.00%
Emerging Market Debt	5.50%	5.00%
Private Credit	8.75%	10.00%
Real Estate	7.63%	5.00%
Absolute Return	5.63%	10.00%
Real Return	6.13%	10.00%
Private Equity	8.25%	10.00%
Cash	1.88%	<u>2.00%</u>
		<u>100.00%</u>

The long-term expected rate of return on plan assets is 6.25%, which was established by the Board of Trustees of the Kentucky Retirement Systems based on a blending of the factors described above.

Discount Rate. The discount rate used to measure the total OPEB liability was 5.83%. This rate is based on the expected rate of return on OPEB plan investments of 6.25% and a municipal bond rate of 3.56%, as reported in Fidelity Index’s “20-Year Municipal GO AA Index” as of June 30, 2017. The projection of cash flows used to determine the discount rate assumed employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26 year amortization period of the unfunded actuarial accrued liability.

**Kentucky Higher Education Assistance Authority/
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June 30, 2018

Note O--Other Post-Employment Benefits ("OPEB")--Continued

Sensitivity of Authority/Corporations proportionate share of the net OPEB liability to changes in the Discount Rate. The following table presents the Authority/Corporation's proportionate share of the net OPEB liability in KRS, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Authority/Corporation's proportionate share of the net OPEB liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	<u>1% Decrease in Discount Rate</u>	<u>Discount Rate</u>	<u>1% Increase in Discount Rate</u>
KRS Discount Rate	4.83%	5.83%	6.83%
Authority's proportionate share of net OPEB liability	\$ 2,525,812	\$ 2,160,437	\$ 1,856,788
Corporation's proportionate share of net OPEB liability	\$ 24,714,068	\$ 21,139,020	\$ 18,167,933

Sensitivity of Authority/Corporations proportionate share of the net OPEB liability to Healthcare Cost Trend Rate. The following table presents the Authority/Corporation's proportionate share of the net OPEB liability in KRS, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Authority/Corporation's proportionate share of the net OPEB liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	<u>1% Decrease in Discount Rate</u>	<u>Discount Rate</u>	<u>1% Increase in Discount Rate</u>
KRS Discount Rate	4.83%	5.83%	6.83%
Authority's proportionate share of net OPEB liability	\$ 1,835,672	\$ 2,160,437	\$ 2,568,237
Corporation's proportionate share of net OPEB liability	\$ 17,961,323	\$ 21,139,020	\$ 25,129,186

OPEB Fiduciary Net Position. Detailed information about KERS's fiduciary net position is available in a KRS financial report. That report may be obtained on the Internet at www.kyret.ky.gov; by writing to Kentucky Retirement Systems at Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601; or by calling 1-800-928-4646.

Payable to the OPEB Plan. At June 30, 2018, the Authority/Corporation reported a payable of \$92,465 for the outstanding amount of contributions to the Insurance Plan required for the year ended June 30, 2018. The Authority's portion is \$6,838 and the Corporation's is \$85,627.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note P--Tuition Benefit Payable

The following assumptions provided by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2018. These assumptions are based on national and state specific economic data, contractual provisions, previous program actuarial valuation reports, historical state general fund appropriations to the University of Kentucky and KCTCS and actual tuition increases from previous years (2002-2017).

Investment Rates - The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. The gross investment yield assumption utilized in the calculation of the tuition benefit payable is based on an investment glide path approach for the Plan. The investments in the Plan will change over time to asset allocations that will reduce equity exposure and try to preserve investment gains. A glide path approach should better match projected payouts as the value of the Plan's assets continues to move closer to its depletion date.

Investment Expenses - The minimum investment expense is assumed to be 20 basis points on all invested assets.

Tuition Increases - Tuition increases are based on the known increases for the next academic year and best estimates of future tuition increases for Kentucky's public colleges and universities. The historical tuition increases are as follows:

- The tuition increases for the 2002-2003 academic year were 32.4% for the Value Plan and 6.4% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2003-2004 academic year were 23.4% for the Value Plan and 14.4% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2004-2005 academic year were 24.3% for the Value Plan and 16.9% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2005-2006 academic year were 6.5% for the Value Plan and 12.5% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2006-2007 academic year were 11.2% for the Value Plan and 12% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2007-2008 academic year were 5.5% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2008-2009 academic year were 5.2% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2009-2010 academic year were 3.3% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.

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Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note P--Tuition Benefit Payable--Continued

- The tuition increases for the 2010-2011 academic year were 4.0% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2011-2012 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2012-2013 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2013-2014 academic year were 2.9% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2014-2015 academic year were 2.1% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2015-2016 academic year were 2.0% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2016-2017 academic year were 4.0% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2017-2018 academic year were 9.0% for the Value Plan and 4.0% for the Standard Plan and the Premium Plan.
- As of June 30, 2018, the tuition increases for the 2018-2019 academic year were 4.1% for the Value Plan and 2.5% for the Standard Plan and the Premium Plan. The tuition increase assumption was 6.00% for the 2018-2019 academic year and 6.00% for each year thereafter until 2026 when all current participant standard utilization periods will expire. The 3% growth limit will apply to remaining accounts through the end of the program in 2028.

For the period from inception to June 30, 2018, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of Kentucky's Affordable Prepaid Tuition Standard and Premium Plans, which represents 95.4% of the Plan's enrollments, has been 7.4%. For the Kentucky Community and Technical College System ("KCTCS"), as applicable to the tuition benefits payout rate of the Value Plan, the average annualized tuition increase from inception to June 30, 2018, has been 8.7%.

Payment of Tuition and Mandatory Fees - Payments of tuition and mandatory fees are assumed to be 128 credit hours of utilization and payments occur twice annually.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note Q--Restricted Net Position

The following categories of restricted net position are included in the combined statement of net position for the following purposes:

- a. **Federal Student Loan Reserve Fund:** Net position is restricted for certain FFELP activities, primarily the payments of claims.
- b. **Agency Operating Fund:** Net position is restricted for certain FFELP activities and other student aid activities.
- c. **Education Finance Funds:** Net position is restricted as required by the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 Indenture, and the 2017 Indenture.
- d. **Corporation Operating Fund:** Net position is primarily restricted for an estimated amount of mandatory repurchases of loans subject to bankruptcy claims.
- e. **Student Aid Funds:** The Student Aid fund balance is restricted for the Student Aid Programs.
- f. **The Trust:** Net position is restricted for use by trust participants.

Note R--Operating Leases

The Authority/Corporation leases office space and equipment under agreements through 2023. Rental and space utilization expense was \$1,397,371 for the year ended June 30, 2018. Minimum future rental payments for real estate and equipment, including common area maintenance commitments, at June 30, 2018 are as follows:

Year Ending June 30:

2019	\$ 1,307,978
2020	1,172,352
2021	666,830
2022	656,802
2023	<u>596,008</u>
	<u>\$ 4,399,970</u>

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note S--Commitments and Contingencies

The FSLRF is contingently liable for loans made by financial institutions that qualify for guarantee. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the fiscal year ended June 30, 2018. Prior to December 1, 2015, the federal government's reinsurance rate for defaults was 100% for loans made prior to October 1, 1993, 98% for loans made on or after October 1993 to September 30, 1998, and 95% for loans made after September 30, 1998. Effective December 1, 2015, the maximum reinsurance rate was amended from 95% to 100%. In the event of future adverse default experience, the FSLRF could be liable for 25% of defaulted loans for a default ratio in excess of 9%. The liability for a default ratio over 5% and up to 9% is 15%. At the beginning of each federal fiscal year, the reinsurance rate returns to applicable baseline; management does not expect that all guaranteed loans could default in one year.

While management believes the FSLRF's expected maximum contingent liability is less than 25% of outstanding guaranteed loans, the maximum contingent liability at June 30, 2018 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 1,588,236,244
Less minimum federal government share - 75%	<u>1,191,177,183</u>
	<u>\$ 397,059,061</u>

Some of the 2014 changes that the Kentucky General Assembly made to Kentucky's Affordable Prepaid Tuition Plan (the "Plan") have been challenged in court. The Kentucky Court of Appeals ruled in the Plan's favor; however, this matter has been referred to the Kentucky Supreme Court. In correspondence with counsel, management believes that the ruling by the court of appeals will be upheld. If the ruling is not upheld, it could result in a material increase to the Plan's actuarially computed tuition benefits payable liability.

Note T--Subsequent Events

On July 18, 2018, the Authority/Corporation issued \$85,000,000 of taxable fixed rate Student Loan Revenue Bonds to continue its Advantage Loan finance program. The \$69,000,000 of 'AA (sf)' rated Series 2018-1A bonds were structured as serial bonds with one super-sinker term bond designed to absorb prepayments. The \$16,000,000 of 'BBB (sf)' rated Series 2018-1B bonds were issued as subordinate bonds. The bonds are scheduled to mature periodically on June 1 beginning in the year 2019 with the last scheduled maturity in 2036.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2018

Note U--Recent Pronouncements

Effective July 1, 2017, the Authority/Corporation was required to adopt GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This statement 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 are also addressed.

GASB No. 75 required retrospective application. Since the Authority/Corporation only presents one year of financial information, the beginning net position was adjusted to reflect the retrospective application. The adjustment resulted in a \$18,438,914 reduction in beginning net position for business-type activities on the Combined Government-Wide Statement of Activities and the Combined Statement of Revenues, Expenditures and Changes in Net Position – Proprietary Funds.

Statement No. 81, *Irrevocable Split-Interest Agreements*, establishes accounting and financial reporting standards for irrevocable split-interest agreements created through trusts, or other legally enforceable agreements. This primarily affects colleges. This Statement was adopted during the current year and did not have an impact on the financial statements.

Statement No. 82, *Pension Issues* – an amendment of GASB Statements No. 67, No. 68, and No. 73. 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 Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contributions requirements. Items 1 and 3 were effective for reporting periods beginning after June 15, 2016 and were adopted in a prior period. Item 2 was adopted during the current year and did not have a significant impact on the financial statements.

Statement No. 86, *Certain Debt Extinguishment Issues*, this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement is applicable to advanced refundings using only existing resources. The Statement was adopted during the current year and did not have an impact on the financial statements.

The GASB has issued several reporting standards that will become effective for fiscal 2019 and later years' financial statements. The Authority/Corporation is currently evaluating the impact that will result from adopting these GASB standards and is therefore unable to disclose the impact that adopting these standards will have on the Authority/Corporation's financial position and the results of its operations when the standards are adopted.

**REQUIRED SUPPLEMENTARY
INFORMATION**

Schedule of Proportionate Share of the Net Pension Liability and Related Ratios
June 30, 2017

**Kentucky Higher Education Assistance Authority/
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	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Authority's proportion of the net pension liability	0.085192%	0.093544%	0.097187%	0.101355%
Authority's proportionate share of the net pension liability	\$ 11,405,792	\$ 10,663,495	\$ 9,749,658	\$ 9,093,000
Authority's covered-employee payroll	\$ 1,317,197	\$ 1,556,281	\$ 1,628,998	\$ 1,740,891
Authority's proportionate share of the net pension liability as a percentage of its covered-employee payroll	865.91%	685.19%	598.51%	522.32%
Plan fiduciary net position as a percentage of the total pension liability	13.30%	14.87%	18.83%	22.32%
	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Corporation's proportion of the net pension liability	0.833570%	0.819117%	0.839524%	0.796208%
Corporation's proportionate share of the net pension liability	\$ 111,601,157	\$ 93,375,171	\$ 84,220,102	\$ 71,434,000
Corporation's covered-employee payroll	\$ 12,888,303	\$ 13,627,623	\$ 14,071,702	\$ 13,672,643
Corporation's proportionate share of the net pension liability as a percentage of its covered-employee payroll	865.91%	685.19%	598.51%	522.46%
Plan fiduciary net position as a percentage of the total pension liability	13.30%	14.87%	18.83%	22.32%
Total collective net pension liability for the Kentucky Employees Retirement System (KERS) non-hazardous employees	\$ 13,388,337,000	\$ 11,399,489,047	\$ 10,031,891,000	\$ 8,971,820,000
KERS' non-hazardous employees total fiduciary net position	\$ 2,056,870,000	\$ 1,980,292,118	\$ 2,327,782,000	\$ 2,578,290,000
KERS' non-hazardous employees total pension liability	\$ 15,445,206,000	\$ 13,379,781,165	\$ 12,359,673,000	\$ 11,550,110,000

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

Schedule of Required Contributions-Pension
June 30, 2017

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Authority's contractually required contribution	\$ 552,959	\$ 479,957	\$ 502,383	\$ 567,008
Authority's contributions in relation to the contractually required contribution	(530,040)	(479,957)	(502,383)	(301,000)
Authority's contribution deficiency	<u>\$ 22,919</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 266,008</u>
Authority's covered-employee payroll	\$ 1,317,197	\$ 1,556,281	\$ 1,628,998	\$ 1,740,891
Authority's contributions as a percentage of covered-employee payroll	40.24%	30.84%	30.84%	17.29%
	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Corporation's contractually required contribution	\$ 5,410,509	\$ 4,202,759	\$ 4,339,713	\$ 4,453,180
Corporation's contributions in relation to the contractually required contribution	(5,186,253)	(4,202,759)	(4,339,713)	(2,364,000)
Corporation's contribution deficiency	<u>\$ 224,256</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,089,180</u>
Corporation's covered-employee payroll	\$ 12,888,303	\$ 13,627,623	\$ 14,071,702	\$ 13,672,643
Corporation's contributions as a percentage of covered-employee payroll	40.24%	30.84%	30.84%	17.29%

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

Note to the Required Supplemental Information-Pension
June 30, 2017

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

Actuarial valuation date	June 30, 2017
Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	26 years
Asset valuation method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Inflation	2.30%
Projected salary increases	0.00%
Investment rate of return	5.25%, net of investment expense, including inflation

Schedule of Proportionate Share of the Net OPEB Liability and Related Ratios
 June 30, 2017

**Kentucky Higher Education Assistance Authority/
 Kentucky Higher Education Student Loan Corporation**

	<u>FY 2017</u>
Authority's proportion of the net OPEB liability	0.085192%
Authority's proportionate share of the net OPEB liability	\$ 2,160,437
Authority's covered-employee payroll	\$ 1,317,197
Authority's proportionate share of the net OPEB liability as a percentage of its covered-employee payroll	164.02%
Plan fiduciary net position as a percentage of the total OPEB liability	24.40%
	<u>FY 2017</u>
Corporation's proportion of the net OPEB liability	0.833570%
Corporation's proportionate share of the net OPEB liability	\$ 21,139,020
Corporation's covered-employee payroll	\$ 12,888,303
Corporation's proportionate share of the net OPEB liability as a percentage of its covered-employee payroll	164.02%
Plan fiduciary net position as a percentage of the total OPEB liability	24.40%
Total collective net OPEB liability for the Kentucky Employees Retirement System (KERS) non-hazardous employees	\$ 2,535,962,000
KERS' non-hazardous employees total fiduciary net position	\$ 817,370,000
KERS' non-hazardous employees total OPEB liability	\$ 3,353,332,000

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

Schedule of Required Contributions-OPEB
 June 30, 2017

**Kentucky Higher Education Assistance Authority/
 Kentucky Higher Education Student Loan Corporation**

	<u>FY 2017</u>
Authority's contractually required contribution	\$ 110,776
Authority's contributions in relation to the contractually required contribution	(109,986)
Authority's contribution deficiency	<u>\$ 790</u>
Authority's covered-employee payroll	\$ 1,317,197
Authority's contributions as a percentage of covered-employee payroll	8.35%
	<u>FY 2017</u>
Corporation's contractually required contribution	\$ 1,083,906
Corporation's contributions in relation to the contractually required contribution	(1,076,173)
Corporation's contribution deficiency	<u>\$ 7,733</u>
Corporation's covered-employee payroll	\$ 12,888,303
Corporation's contributions as a percentage of covered-employee payroll	8.35%

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

Note to the Required Supplemental Information-OPEB
June 30, 2017

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

Actuarial valuation date	June 30, 2017
Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	26 years
Asset valuation method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Inflation	2.30%
Projected salary increases	0.00%
Investment rate of return	6.25%, net of investment expense, including inflation
Healthcare Trend Rates Pre-65	Initial trend starting at 7.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 5 years
Healthcare Trend Rates Post-65	Initial trend starting at 5.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 2 years