

**The accompanying financial statements and report are intended for the original recipient. They must be presented in their entirety and may not be modified in any manner.**



MONTANA HIGHER EDUCATION  
STUDENT ASSISTANCE CORPORATION

FINANCIAL REPORT

JUNE 30, 2016

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Montana Higher Education  
Student Assistance Corporation  
Helena, Montana

We have audited the accompanying financial statements of the Montana Higher Education Student Assistance Corporation (the Corporation) as of June 30, 2016, which comprise the statement of financial position as of June 30, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these 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.

### **Auditor's Responsibility**

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of June 30, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Report on Summarized Comparative Information**

We have previously audited the Corporation's 2015 financial statements, and our report dated September 11, 2015, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

**Report on Supplementary Information**

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The combining schedule of assets, liabilities and net assets under bond indentures and combining schedule of activities and net assets under bond indentures on pages 30 and 31 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Management's financial analysis, which is the responsibility of management, includes information of a nonaccounting nature and has not been subjected to the auditing procedures applied in the audit of the financial statements. Accordingly, we do not express an opinion or provide any assurance on it.

**Change in Reporting Model**

As more fully disclosed in Note 1, the Corporation changed its reporting model for the year ended June 30, 2016, from that prescribed by the Governmental Accounting Standards Board (GASB) for governmental nonprofit organizations to that prescribed by the Financial Accounting Standards Board (FASB) for other nonprofit entities. All prior year balances have been restated to conform to the 2016 presentation.



Helena, Montana  
September 15, 2016

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
MANAGEMENT'S FINANCIAL ANALYSIS  
Year Ended June 30, 2016 and Comparative Totals for June 30, 2015

This section of the Montana Higher Education Student Assistance Corporation's (MHESAC or the Corporation) annual financial report presents our discussion and analysis of the Corporation's financial performance during the years ended June 30, 2016 and 2015. Please read the following in conjunction with the Corporation's financial statements and accompanying notes.

MHESAC is a Montana not-for-profit corporation that was incorporated in 1980. MHESAC was originally designated as the sole and exclusive not-for-profit corporation in the State to provide a student loan secondary market to support the Federal Family Education Loan Program (FFELP). MHESAC is supported entirely through earnings on the student loans that it owns. MHESAC's current activities include FFELP student loan servicing and bond management to finance the capital for its FFELP student loan activities and rebates and rate reductions to student loan borrowers as part of its commitment to helping Montana students lower the cost of financing their education. MHESAC previously had the ability to issue tax-exempt debt, and therefore was classified as a "governmental nonprofit" entity for accounting purposes. In June 2015, MHESAC initiated organizational changes that eliminated its ability to issue tax-exempt debt and therefore believes that it is no longer appropriate to use GASB as the basis for financial statement presentation. The financial statements are now being presented in accordance with FASB standards for the fiscal year ended June 30, 2016, and the comparative year ended June 30, 2015, has been converted to FASB format.

**Financial Reporting Methodology Overview**

This annual report consists of MHESAC's basic financial statements and Management's Financial Analysis, a discussion of results of operations and financial position. The financial statements are presented using accrual basis of accounting.

The basic financial statements include the statement of financial position, which reports the assets owned by MHESAC, its liabilities or what it owes to others and net assets as of its fiscal year end; the statement of activities, which reports the operating net income and change in net assets; and a statement of cash flows, which describes the sources and uses of MHESAC's cash during the year.

It is important to note that although MHESAC's assets and net position are unrestricted per the FASB definition and there are no donor imposed restrictions, there are legal agreements in place that place limitations on the use of a significant portion of the assets of MHESAC. Specifically, there are legal constraints on the assets and net position whose use is restricted by the bond indenture or escrow agreement and they cannot be used for any other purpose. These legal restrictions do not apply to assets and net position that are located in what we call the general fund. The unrestricted assets were either acquired outside of the bond indenture or escrow agreement through general fund operations or from previously restricted funds that have now been released to the general fund via indenture satisfaction such as full redemption of outstanding bond issues.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)  
Year Ended June 30, 2016 and Comparative Totals for June 30, 2015

**Financial Position Summary**

Following is an analysis of MHESAC's financial position at June 30, 2016 with comparative information at June 30, 2015 (000s omitted):

<b>Assets</b>	<b><u>2016</u></b>	<b><u>2015</u></b>
Cash and cash equivalents	\$ 31,683	\$ 33,422
Educational loans receivable, net	916,972	1,024,273
Other assets	<u>16,778</u>	<u>16,856</u>
Total Assets	<u>\$ 965,433</u>	<u>\$ 1,074,551</u>
<b>Liabilities and Net Assets</b>		
Current liabilities	106,875	119,201
Long term debt and obligations	<u>763,200</u>	<u>855,708</u>
Total Liabilities	<u>870,075</u>	<u>974,909</u>
Net assets:		
Escrow/Trust	61,723	66,022
General Fund	<u>33,635</u>	<u>33,620</u>
Total net assets	<u>95,358</u>	<u>99,642</u>
Total liabilities and net assets	<u>\$ 965,433</u>	<u>\$ 1,074,551</u>

At June 30, 2016, MHESAC had cash and cash equivalents of over \$31.7 million of which approximately \$21.9 million is limited as to use under the bond indenture. Another \$7 million is limited as to use under the escrow agreement and the remaining \$2.9 million has no restrictions by either donor or legal document. The cash equivalents held by the trustee in the indenture is made up of cash temporarily held by the trustee in short-term investments until the funds are used for debt service. Additionally, cash is held by the trustee for reserve and administration purposes in short-term investments that by definition are cash equivalents.

Following is a breakdown of the different loan types held by MHESAC at June 30, 2016 (gross loan amounts):

Stafford	\$ 180,028,599
PLUS	10,000,559
Consolidation	727,384,380
Other	<u>136,193</u>
Total	<u>\$ 917,549,731</u>

During the fiscal year MHESAC decreased the reserve for bad debts which reflects a small change in exposure to bad debt due to slightly decreased historical default rates as well as an overall decrease in the total receivables to which it applies. The reserve, which is netted against the student loans receivable for financial statement presentation decreased from \$670,667 to \$547,751. There is also a discount for student loan purchase of \$29,428 that is also netted against the receivable.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)  
Year Ended June 30, 2016 and Comparative Totals for June 30, 2015

**Results of Operations Summary**

MHESAC is reporting a negative change in net assets of \$4,285,218 for the fiscal year ended June 30, 2016. Please see the following analysis of operating revenue and expense sources (000s omitted):

**Revenue Sources**

	<u>2016</u>	<u>2015</u>
Interest on investments	\$ 315	\$ 222
Interest on student loans	29,561	31,596
Loss on early redemption of bonds	(439)	(761)
Other gains	6	-
Total operating revenue	<u>29,443</u>	<u>31,057</u>

**Operating Expense Sources**

Bond and note interest	14,927	14,489
Bond fees	195	195
Loan fees	8,188	9,002
Management & servicing cost	10,049	10,606
Other costs	368	332
Total operating expenses	<u>33,727</u>	<u>34,624</u>

<b>Change in net assets</b>	<b>(4,284)</b>	<b>(3,567)</b>
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<b>Net assets, beginning of year</b>	<b><u>99,642</u></b>	<b><u>103,209</u></b>
<b>Net assets, end of year</b>	<b><u>\$ 95,358</u></b>	<b><u>\$ 99,642</u></b>

The following is an overview of changes in financial data from FY 15 to FY 16:

- Cash and equivalents decreased by \$1,739,000
- Investments increased by \$1,502,000
- Net student loan receivables decreased by \$107,301,000
- Debt consisting of bonds outstanding decreased by \$104,488,000
- MHESAC's net assets decreased by \$4,284,000
- Total operating revenues decreased by \$1,614,000
- Total expenses decreased by \$897,000

What the comparative financial statements tell us is that MHESAC's financial health continues to remain on the path that was modeled for it in fiscal year 2012 when it restructured its debt portfolio. While the new debt is not as advantageous in a low interest rate environment as the auction rate bonds that were restructured, the indenture is structured to survive the life of the bonds and the expected rise in future interest rates.



MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)  
Year Ended June 30, 2016 and Comparative Totals for June 30, 2015

**Results of Operations Summary (Continued)**

The expense line for bond interest includes \$2,533,568 for bond discount amortization which is a non-cash expense item. Additionally, the revenue line includes a loss on early redemption of bonds in the amount of \$439,000 for the write off of bond discount related to bonds redeemed earlier than scheduled.

Operating revenues from the student loans are variable in nature and were based on the one-month LIBOR rate during fiscal years 2016 and 2015. At the beginning of the year, the one-month LIBOR rate was 0.1865% and at the end of the year it was 0.4651%. As a result, interest earned on student loans was higher in fiscal year 2016 as compared to the previous year relative to portfolio balance. The return was higher due to the increase in the index rate over the course of the year offset by the portfolio decline that was experienced as the student loans continue to amortize.

**Long-term Debt Activity**

MHESAC had previously issued both tax-exempt and taxable bonds to raise capital for its student loan origination and acquisition activities as more fully described in the accompanying notes to the financial statements. During fiscal year 2012, MHESAC had the opportunity to restructure its debt with the goal of taking out all auction bonds that had been illiquid since 2008 and all fixed rate bonds that paid a significantly higher than market interest rate and structure MHESAC's debt so that any vulnerability to rising interest rates is mitigated. The 2012 Bonds that were issued in the amount of \$1,164,800,000 met those goals. \$1,145,300,000 of the bonds that were issued were senior bonds and all senior bonds carry a AAA rating by Fitch. Standard & Poor's also rated the 2012 bonds and the Senior Series A2 carry a AAA rating and the Senior Series A3 carry a AA+ rating by Standard & Poor's. The subordinate bonds issued, in the amount of \$19,500,000 are unrated and are held by MHESAC. The floating rate notes in Series 2005B and 2006A remain outstanding and carry a Aaa rating by Moody's and Fitch and a AAA rating from Standard & Poor's. The 2006C subordinate bonds in the amount of \$18,000,000 are unrated. Currently, all outstanding bonds are taxable bonds and carry variable interest rates based on either 1-month or 3-month LIBOR rates plus some spread depending on the life of the bond.

In the fiscal year that ended June 30, 2016, MHESAC redeemed outstanding bonds with all cash available and allowable by the indenture through scheduled and/or targeted redemptions. Redemptions made totaled \$107,461,000. An analysis of the change to bonds outstanding follows (including \$19,500,000 internally held bonds eliminated in the statement of financial position):

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)  
Year Ended June 30, 2016 and Comparative Totals for June 30, 2015

**Long-term Debt Activity (Continued)**

	<u>Current Portion</u>	<u>Long-term Portion</u>
Net bonds outstanding at 7/01/15	\$ 114,281,000	\$ 875,208,121
Scheduled, targeted payments of 2005, 2006 and 2012 Series bonds	(107,461,000)	-
Amortization of bond discount	-	2,972,444
Reclassification to current	<u>95,481,000</u>	<u>(95,481,000)</u>
Net bonds outstanding at 6/30/16	<u>\$ 102,301,000</u>	<u>\$ 782,699,565</u>

It should be noted that \$19,500,000 of the 2012 bonds issued are unrated subordinate bonds and are owned by the MHESAC general fund. They have therefore been eliminated in the consolidated financial statements.

**Significant Events**

The Student Aid and Fiscal Responsibility Act (SAFRA), which was included in the health care reconciliation bill that was signed into law on March 30, 2010, effectively eliminated the Federal Family Education Loan Program (FFELP) that MHESAC participated in. Effective July 1, 2010, all new federal student loans were provided by the Direct Loan program rather than by the private sector participants. Therefore, MHESAC is no longer originating or acquiring new loans. MHESAC will continue to service its existing FFELP student loan portfolio during the remaining life of those loans which can be up to thirty years.

Effective April 1, 2012, MHESAC elected to change the index that was used for the formula for special allowance payments (SAP) to be received from or paid to the federal government. Prior to this election, SAP was calculated based on a formula that involved the 90-day commercial paper rate. MHESAC made the election to switch to a formula based on the 1-month LIBOR rate in order to better match the indices used for calculation of student loan earnings and associated debt. During fiscal year 2016, the 1-month LIBOR rate averaged 0.332% and the 90-day commercial paper rate averaged 0.427%. This resulted in a return on student loans that was 0.095% lower than if the election had not been made.

FINANCIAL STATEMENTS

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
STATEMENT OF FINANCIAL POSITION  
June 30, 2016 with Comparative Totals for 2015  
(expressed in thousands)

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 2,875	\$ 3,174
Investments	1,502	-
Accrued interest receivable	197	176
Educational loans receivable, net	650	793
Prepaid costs,		
net of accumulated amortization	24	10
Other assets	46	71
Total Current Assets	5,295	4,224
<b>RESTRICTED ASSETS, CURRENT</b>		
Cash and cash equivalents	28,808	30,248
Accrued interest receivable	14,608	14,794
Educational loans receivable, net	94,706	106,603
Prepaid costs,		
net of accumulated amortization	24	25
Other assets	376	1,780
Total Restricted Assets, Current	138,522	153,450
<b>NON-CURRENT ASSETS</b>		
Educational loans receivable, net	8,803	9,930
Restricted educational loans receivable, net	812,813	906,947
Total Non-Current Assets	821,616	916,877
<b>TOTAL ASSETS</b>	<b>\$ 965,433</b>	<b>\$ 1,074,551</b>

The Notes to the Financial Statements are an integral part of this statement.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
STATEMENT OF FINANCIAL POSITION (CONTINUED)  
June 30, 2016 with Comparative Totals for 2015  
(expressed in thousands)

	<u>2016</u>	<u>2015</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 4,145	\$ 4,597
Accrued interest payable	429	323
Educational loan revenue bonds payable - current portion	<u>102,301</u>	<u>114,281</u>
Total Current Liabilities	<u>106,875</u>	<u>119,201</u>
LONG-TERM LIABILITIES		
Educational loan revenue bonds payable, net	<u>763,200</u>	<u>855,708</u>
Total Long-Term Liabilities	<u>763,200</u>	<u>855,708</u>
Total Liabilities	<u>870,075</u>	<u>974,909</u>
NET ASSETS		
Unrestricted:		
Escrow/Trust	61,723	66,022
General Fund	<u>33,635</u>	<u>33,620</u>
Total net assets	<u>95,358</u>	<u>99,642</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 965,433</u>	<u>\$ 1,074,551</u>

The Notes to the Financial Statements are an integral part of this statement.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
STATEMENT OF ACTIVITIES

For the Year Ended June 30, 2016 with Comparative Totals for 2015  
(expressed in thousands)

	<u>2016</u>	<u>2015</u>
Revenue and Gains		
Investment income	315	222
Unrealized gain on fair mkt valuation	2	-
Interest on educational loans	29,561	31,596
Loss on early redemption of bonds	(439)	(761)
Gain on purchase of loans	4	-
Total unrestricted revenue and gains	<u>29,443</u>	<u>31,057</u>
Operating Expenses		
Bond interest	14,927	14,489
Servicing fees	8,139	8,656
Trustee fees	140	156
Surveillance fees	38	37
Listing fees	17	2
Borrower rebates	110	157
Consolidation loan fees	8,078	8,845
Uncollectible accounts	(107)	(55)
Total program operating expenses	<u>31,342</u>	<u>32,287</u>
General and Administrative Expenses		
Management fee	1,910	1,950
Dues and subscriptions	14	-
Professional services	428	356
Board and officer compensation	17	16
Insurance	16	15
Total General and Administrative expenses	<u>2,385</u>	<u>2,337</u>
Change in net assets	(4,284)	(3,567)
Net assets at the beginning of the year	<u>99,642</u>	<u>103,209</u>
Net assets at the end of the year	<u>\$ 95,358</u>	<u>\$ 99,642</u>

The Notes to the Financial Statements are an integral part of this statement.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
STATEMENT OF CASH FLOWS  
For the Year Ended June 30, 2016 with Comparative Totals for 2015  
(expressed in thousands)

	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Interest received on student loans	\$ 18,428	\$ 18,361
Interest received on investments	371	279
Bond and note interest paid	(12,399)	(12,003)
Bond fees paid	(154)	(157)
Loan fees paid	(8,107)	(8,912)
Contracted management & servicing fees paid	(9,539)	(10,486)
Strategic planning fees paid	(408)	(300)
Administrative expenses paid	<u>(47)</u>	<u>(31)</u>
Net cash flows from operating activities	<u>(11,855)</u>	<u>(13,249)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of educational loans	(4,059)	(6,588)
Repayments of educational loans	123,138	137,731
Proceeds from sale of investments	<u>(1,502)</u>	<u>-</u>
Net cash flows from investing activities	<u>117,577</u>	<u>131,143</u>
<b>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</b>		
Repayment of bonds	<u>(107,461)</u>	<u>(117,450)</u>
Net cash flows from financing activities	<u>(107,461)</u>	<u>(117,450)</u>
Net change in cash and equivalents	(1,739)	444
Cash and cash equivalents, beginning of year	<u>33,422</u>	<u>32,978</u>
Cash and cash equivalents, end of year	<u>\$ 31,683</u>	<u>\$ 33,422</u>

The Notes to the Financial Statements are an integral part of this statement.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
STATEMENT OF CASH FLOWS (CONTINUED)  
For the Year Ended June 30, 2016 with Comparative Totals for 2015  
(expressed in thousands)

	<u>2016</u>	<u>2015</u>
A reconciliation of cash and cash equivalents as shown on the balance sheet for MHESAC follows:		
Cash and cash equivalents	\$ 2,875	\$ 3,174
Restricted cash and cash equivalents	<u>28,808</u>	<u>30,248</u>
Cash and cash equivalents	<u>\$ 31,683</u>	<u>\$ 33,422</u>
A reconciliation of operating income to net cash flows from operating activities follows:		
Operating income	\$ (4,284)	\$ (3,567)
Adjustments to reconcile operating income to net cash flows from operations:		
Uncollectible accounts	107	55
Discounted bond accretion	2,534	2,659
Loss on early redemption	439	761
Change in current assets and liabilities:		
Interest receivable	(12,097)	(12,590)
Other assets	1,787	49
Accounts payable and accrued expenses	(451)	(534)
Accrued interest payable	<u>110</u>	<u>(82)</u>
Net cash flows from operating activities	<u>\$ (11,855)</u>	<u>\$ (13,249)</u>
Supplemental Information:		
Non-cash Investing and Financing Activity:		
Accrued interest capitalized	12,178	\$ 12,891
Student loan borrower rebates granted	<u>111</u>	<u>157</u>
	<u>\$ 12,289</u>	<u>\$ 13,048</u>

The Notes to the Financial Statements are an integral part of this statement.



MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2016

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization**

Montana Higher Education Student Assistance Corporation (herein referred to as MHESAC or the Corporation) is a Montana not-for-profit corporation incorporated in 1980. The governor of the State of Montana has designated MHESAC as the sole and exclusive not-for-profit corporation in the State to provide a statewide student loan acquisition program in connection with the guaranteed student loan program provided by the Higher Education Act and Section 103(e) of the Internal Revenue Code. The Corporation was organized exclusively for the purposes of lending and providing funds for the acquisition of student loans and performing procedures for servicing loans. Effective July 1, 2010, the Federal Family Education Loan program (FFELP) was eliminated and replaced by the Federal Direct Loan program. MHESAC will no longer acquire or provide capital for new FFELP student loans. On February 1, 2000, the Corporation sold all its operating assets and transferred its employees to Student Assistance Foundation of Montana (SAF), a Montana not-for-profit corporation. The Corporation and SAF entered into management and servicing agreements, pursuant to which SAF agrees (1) to provide the Corporation with all necessary management and administrative services, including those required to operate the Corporation's student loan program and to perform the Corporation's responsibilities under the Indenture, and (2) to service all student loans owned by MHESAC.

**Income Tax Status**

MHESAC is a not-for-profit corporation exempt from taxation under Internal Revenue Code Section 501(c)(3). Accordingly, no provision for income taxes is necessary in the accompanying financial statements.

Generally, the Corporation's returns are no longer subject to review by federal taxing authorities for years prior to the tax year ended June 30, 2013.

**Basis of Presentation**

MHESAC has operated as a non-profit entity that had the ability to issue tax-exempt debt and was classified as a "governmental nonprofit" entity in accordance with U.S. generally accepted accounting principles (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB) for the fiscal year ended June 30, 2015. As provided by these standards, MHESAC followed proprietary fund accounting. In June of 2015, MHESAC initiated organizational changes that resulted in a change to its ability to issue tax-exempt debt and subsequently its classification as a "governmental nonprofit" was evaluated.

Effective June 27, 2015, MHESAC's 150(d) status changed and it no longer has the ability to issue tax-exempt debt. For fiscal years beginning July 1, 2015, the financial statements are presented in accordance with GAAP as codified by the Financial Accounting Standards Board (FASB).

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Basis of Presentation (Continued)**

The Statement of Cash Flows is presented using the direct method. MHESAC considers the following revenue components to be operating income: interest income derived from investments, cash equivalents and educational loans as well as other miscellaneous income.

Management's Financial Analysis is not required supplemental information under FASB standards. MHESAC has chosen to present this information and it precedes the financial statements.

**Accounting Estimates**

The preparation of financial statements in conformity with GAAP requires 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 financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**Classification of Net Assets**

The Corporation reports information regarding its financial position and activities according to three classes: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The net assets are reported as follows:

*Unrestricted Net Assets* – Net assets that are not subject to donor-imposed stipulations.

*Temporarily Restricted Net Assets* – Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Corporation or the passage of time. When a restriction expires (that is, when a stipulated time restriction ends or purpose of restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. The Corporation had no temporarily restricted net assets at June 30, 2016.

*Permanently Restricted Net Assets* – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Corporation, but permit the use of all or part of the income earned on any related investment for general or specific purposes. The Corporation had no permanently restricted net assets at June 30, 2016.

**Cash and Cash Equivalents**

Cash and cash equivalents includes all checking accounts, money market accounts, and highly liquid securities with a maturity of three months or less at the date of purchase. It also includes cash and liquid investments held by the trustee for the bond financings and cash held in escrow for the general operating fund that is being held in short-term or liquid investments pursuant to the Escrow Agreement among MHESAC, Student Assistance Foundation, and the Escrow Agent, dated May 4, 2012.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Investments**

The Corporation has investments in certificates of deposit. These investments are carried at fair value.

**Interest on Educational Loans**

The United States Department of Education makes quarterly interest payments on subsidized Stafford and subsidized Consolidation loans until the borrower is required to begin repayment under the provisions of the Higher Education Act. For Stafford loans, repayment generally begins 6 to 9 months after the student completes his/her course of study, leaves school, or fails to carry a minimum academic load. Repayment begins immediately upon full disbursement for Consolidation, PLUS, and SLS loans disbursed prior to July 1, 2008. PLUS loan borrowers with loans disbursed on or after July 1, 2008, may choose to begin repayment 6 months after the student, for whom the parent borrowed the funds, ceases to be enrolled at least half-time. In addition, the United States Department of Education pays the interest for subsidized Stafford and subsidized Consolidation loans during the time a borrower is in an authorized deferment period. Authorized deferment periods are specific situations and statuses determined by the United States Department of Education.

**Special Allowance Payments**

The United States Department of Education provides a special allowance or subsidy to lenders participating in FFELP if the interest rate is below the guaranteed interest rate. Conversely, if the average yield rate is lower than the interest rate paid by the borrower, then the excess portion of the borrower payment is rebated to the federal government. This allowance is paid on the average quarterly unpaid principal balance of student loans, based on an annual rate equal to the average rate of 91-day U.S. Treasury Bills, 3-month Commercial Paper Rates or One-Month LIBOR for that quarter increased by various rates, depending on loan type and origination date. As of June 30, 2016, rebates of \$13,173,267 were netted in interest on educational loans on the financial statements.

During the year ended June 30, 2010, the Income Based Repayment (IBR) Plan was enacted as part of the College Cost Reduction and Access Act of 2007. IBR is a repayment plan option for borrowers with loans in the Direct Loan Program or FFELP. The IBR plan may result in additional subsidy payments by the federal government on behalf of borrowers and a potential discharge of remaining debt balances at the end of 25 years.

**Loan Measurement & Allowance for Uncollectible Loans**

Loans held by the corporation are measured at the outstanding principal amount net of any allowance for credit losses or uncollectible amounts. Estimates for uncollectible amounts are based on outstanding principal amounts and portfolio default rates. (See Note 4 for details on Education Loan Receivable and Uncollectible Loans).

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Escrow/Trust Net Assets**

In connection with the issuance of the Series 2012 Bonds, assets were placed in escrow in order to assure that the Corporation will have sufficient funds to pay servicing and management fees over the life of the indenture. Specified cash and student loans (including, without limitation, all principal, interest, special allowance payments, and guarantee or insurance payments with respect thereto) received by MHESAC have been deposited in an escrow account.

Loans held in the escrow total \$10,458,033 net of an allowance for uncollectible accounts of \$6,946. Cash of \$6,979,698, accrued interest receivable of \$12,875, repayment interest receivable of \$156,186 and other assets of \$15,213 were held in the escrow as of June 30, 2016. Total assets of \$17,622,005 less associated liabilities of \$271,477 equal \$17,350,528, the portion of the unrestricted Escrow/Trust net assets related to the assets held in escrow.

Other Escrow/Trust assets represent revenue bond funds that are required to be expended only as prescribed by the bond indenture. Due to the limited obligation nature of this debt, the funds and accounts established by the indenture are pledged as collateral for the bonds under the indenture. The balance of the unrestricted Escrow/Trust net assets attributable to the revenue bond funds totals \$44,372,581. The Escrow and Trust related net assets total \$61,723,109.

**Reclassification**

Certain reclassifications were made to the 2015 financial statements in order to conform to the 2016 presentation. The reclassifications are related to the move from GASB to FASB as discussed in the Basis of Presentation section prior. The change in presentation does affect how assets and net assets are presented. Under GASB, assets and net assets related to the Trust and Escrow were reported as restricted due to the limitations imposed by the indenture and escrow agreement. Reporting under FASB requires these assets to be presented as unrestricted assets and unrestricted net assets because, although they are restricted based on legal agreements, there are no donor-imposed restrictions.

**NOTE 2. CONCENTRATION OF CREDIT RISK**

Financial instruments that potentially subject the Corporation to concentrations of credit risk consist of cash and certificates of deposit. MHESAC maintains cash deposits at one financial institution and invests in certificates of deposits in six other institutions. Accounts at these financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 for interest bearing and non-interest bearing accounts. At June 30, 2016, both the book and bank balance amount of MHESAC deposits was \$3,755,656 with \$2,005,656 exceeding FDIC limits.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 3. INVESTMENTS**

Since the Escrow and Trust assets are governed by a bond indenture and related escrow agreement, the Corporation adheres to the requirements specified within the bond indenture for investment activity of those assets. The Corporation has adopted a formal internal policy related to the investment of the general operating fund activity that is in accordance with the Internal Revenue Code and the prudent expert principle. General operating funds are assets held outside of the bond indenture.

The general operating fund owns \$19,500,000 of the 2012 bonds issued under the MHESAC indenture. This activity is eliminated in the financial statements.

The Corporation follows the guidance established for measuring fair value under GAAP and related disclosure requirements. Fair value is defined by GAAP as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date in the principal or most advantageous market for the specific asset or liability.

Fair value measurement assumes the highest and best use of the asset by market participants and requires valuation techniques that maximize use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy prioritizes valuation input into three broad levels.

- Level 1 – Quoted prices in active markets for identical assets or liabilities;
- Level 2 – Significant observable inputs other than Level 1 such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active, or inputs other than quoted prices that are observable or can be corroborated by observable market data. This level input must be observable for substantially the full term of the assets or liabilities;
- Level 3 – Significant unobservable inputs for situations in which there is little, if any, market activity.

Investments held by the Corporation at June 30, 2016 are comprised of certificates of deposit, for which cost approximates fair value. Certificates of deposit are not subject to investment categorization requirements.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 3. INVESTMENTS (CONTINUED)**

The following summarizes investments held at June 30, 2016:

<u>INVESTMENTS</u>	<u>AMOUNT</u>	<u>RATE</u>	<u>MATURITY</u>
Wells Fargo MT Higher Ed 2012–B Security	\$ 19,500,000	1.408%	12/20/2044
Apple Bank	250,044	0.45%	10/06/2016
BMO Harris Bank	250,144	0.55%	01/06/2017
Plains Capital Bank	250,279	0.60%	04/06/2017
Santander Bank	250,260	0.70%	04/06/2017
Capital One Bank USA	250,497	0.75%	10/06/2017
Comenity Capital Bank	<u>250,771</u>	1.05%	04/04/2018
	21,001,995		
Less intercompany holding:			
Wells Fargo MT Higher Ed 2012-B Security	<u>(19,500,000)</u>		
<b>TOTAL INVESTMENTS</b>	<b><u>\$ 1,501,995</u></b>		

**NOTE 4. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES**

The educational loans receivable are loan portfolios purchased from various banks and other financial institutions as well as loans originated by MHESAC. Purchased and originated portfolios are accounted for in the same manner. Servicing of these loans is governed by regulations issued by the Department of Education under FFELP.

The educational loans receivable are classified as student/interim or repayment status. Student/interim status represents the period from the date the educational loan is made until a student is out of school, including the grace period and any authorized deferment periods, at which time repayment status commences. The educational loans receivable are disclosed in the financial statements net of allowances for uncollectible loans.

Educational loans are summarized as follows as of June 30, 2016:

Student/interim status	\$ 205,993,967
Repayment status	<u>711,555,764</u>
Educational loans receivable	917,549,731
Allowance for uncollectible loans	(547,751)
Discount on loan purchase	<u>(29,428)</u>
Educational loans receivable, net	<b><u>\$ 916,972,552</u></b>

In addition to the special allowance paid by the federal government on certain loans, payments of principal and interest are made by the borrower using the various rates and terms for loans outstanding. Interest on performing loans is accrued on the outstanding principal balance.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 4. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES**  
**(CONTINUED)**

Depending on factors specified in the Higher Education Act, educational loans have either fixed or variable interest rates and various maximum repayment terms. Fixed interest rates to the borrower on Consolidation loans are based upon the weighted average interest rates of the loans consolidated rounded up to the nearest one-eighth or whole percentage depending on the disbursement date. Consolidation loans disbursed on or after November 13, 1997 have a maximum interest rate of 8.25%.

Variable interest rates to the borrower are based upon either the 91 day or one year constant maturity Treasury bill, subject to maximum interest rates ranging from 7.00% to 12.00%. Fixed interest rates range from 3.4% to 8.5% depending on the actual year disbursed and the loan type.

SLS, PLUS, and FISL loans have a maximum repayment term of 10 years. Stafford loans have maximum repayment terms of 10 or 25 years depending on the borrower's original disbursement date and cumulative balance. Consolidation loans have maximum repayment terms of 10 to 30 years depending on the original balance.

**Allowance for Uncollectible Loans**

Under contracts with the Montana Guaranteed Student Loan Program (MGSLP), other non-Montana guarantors, and the United States Department of Education, MHESAC is guaranteed reimbursement of principal and accrued interest on defaulted educational loans for which the applicable due diligence procedures have been performed. The Corporation receives 100% reimbursement on loans disbursed prior to October 1, 1993. Loans disbursed on or after October 1, 1993, until June 30, 2006, are reimbursed at 98% and loans disbursed on or after June 30, 2006, are reimbursed at 97%.

The Corporation recognizes an allowance for loan losses in an amount believed to be sufficient to absorb losses inherent in our loan portfolio. This provision is based on the current default rates of each segment of the portfolio funding source that is applied to the non-guaranteed portion of the loan portfolio balance. A provision for uncollectible educational loans has been made for the year ended June 30, 2016.

Defaulted loans are eligible for claims reimbursement after 270 days of delinquency. At this time, default prevention due diligence is conducted in an attempt to prevent the need for claim submission. The Corporation files claim prior to the 360<sup>th</sup> day of delinquency, the deadline required by the guarantor. Interest is accrued on delinquent loans up to the date of claim payment by the guarantor, if applicable. At June 30, 2016, loans in the amount of \$9,646,565 were classified as delinquent more than 270 days, the stage at which a default claim can be filed.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 4. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES**  
**(CONTINUED)**

**Allowance for Uncollectible Loans (Continued)**

As of June 30, 2016, MHESAC held a loan portfolio of \$917,549,731. The average default rate for loans serviced by SAF resulted in a provision for uncollectible educational loans of \$439,269 for the year ended June 30, 2016. A default rate of 50% was used for loans serviced by a collection agency resulting in an uncollectible amount of \$108,482.

Following is a reconciliation of the change in the allowance for uncollectible loans for the year ended June 30, 2016:

Balance, July 1, 2015	\$ 670,667
Non-guaranteed write-offs	(8,814)
Adjustments per allowance policy	<u>(114,102)</u>
Balance, June 30, 2016	<u>\$ 547,751</u>

There is also a discount for student loan purchase of \$29,428 that is also netted against the receivable.

Loan guarantor rates are considered segments for purposes of GAAP disclosure. Following is a breakdown by loan guarantor rates of the current loan portfolios held at June 30, 2016:

100% Guarantee	\$ 1,144,222
98% Guarantee	532,407,457
97% Guarantee	383,714,130
Uninsured	<u>283,922</u>
<b>TOTAL PORTFOLIO</b>	<b><u>\$ 916,972,552</u></b>

No changes were implemented in the accounting policies or methodologies during the year ended June 30, 2016 regarding calculation of the allowance for uncollectible loans.

**NOTE 5. RELATED PARTY TRANSACTIONS**

MHESAC has entered into agreements with SAF to provide management and loan servicing to MHESAC. SAF has one of its Board members in common with the Corporation's seven Board members. Effective February 1, 2000, the Corporation transferred, for fair value, all of its operations and non-financial assets including personnel, all furniture and equipment, as well as its interest in the office building to SAF.



MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE**

**Educational Loan Revenue Bonds Payable**

The bonds outstanding are summarized in the table below, including the internally held bond in the amount of \$19,500,000:

Bonds outstanding at June 30, 2015, net	\$ 989,489,121
Bond discount amortization during the year	2,533,569
Loss on early redemption of bonds	438,876
Bonds redeemed during the year	<u>(107,461,000)</u>
Bonds outstanding	885,000,565
Less: internal 2012 bond holding	<u>(19,500,000)</u>
Bonds outstanding at June 30, 2016, net	<u>\$ 865,500,565</u>

A description of significant terms and conditions of each Student Loan Revenue Bond issue outstanding at June 30, 2016 follows:

<u>Issue</u>	<u>Year End Interest Rate</u>	<u>Original Issue Amount</u>	<u>June 30, 2016</u>
<b>Taxable Floating Rate Bonds:</b>			
2005 Series B Bonds	0.767%	\$ 119,140,000	\$ 43,846,000
2006 Series A Bonds	0.747%	226,775,000	26,180,000
2006 Series C Bonds **	1.648%	30,000,000	18,000,000
2012 Series A-2 Bonds	1.448%	649,000,000	491,657,000
2012 Series A-3 Bonds	1.498%	305,300,000	305,300,000
2012 Series B-1 **	1.648%	<u>19,500,000</u>	<u>19,500,000</u>
Total Bonds		1,349,715,000	904,483,000
Less Discount		<u>(31,625,846)</u>	<u>(19,482,435)</u>
<b>TOTAL BONDS</b>		<u>\$1,318,089,154</u>	<u>\$ 885,000,565</u>

The Bonds are limited obligations of the Corporation payable solely from and secured by specific revenues and funds as described in the indenture. All of the outstanding bonds are taxable.

\*\* These bonds are classified as subordinate bonds and all other bonds reported have payment and certain other priorities over these bonds.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)**

<u>Issue</u>	<u>Original Issue Date</u>	<u>Average Interest Rate from Issuance Date to Current</u>	<u>Maturity Date</u>	<u>Interest Due Status</u>	<u>Variable Rate Basis</u>	<u>June 30, 2016</u>
2005 Senior Series B	5/26/2005	2.09%	6/20/2030	Quarterly	3 month LIBOR + 12 basis points	\$ 43,846,000
2006 Senior Series A	5/3/2006	2.09%	3/20/2024	Quarterly	3 month LIBOR + 10 basis points	26,180,000
2006 Subordinate Series C	5/3/2006	1.42%	12/20/2046	Monthly	1 month LIBOR + 120 basis points	18,000,000
2012 Senior Series A-2	5/4/2012	1.22%	5/20/2030	Monthly	1 month LIBOR + 100 basis points	491,657,000
2012 Senior Series A-3	5/4/2012	1.27%	7/20/2043	Monthly	1 month LIBOR + 105 basis points	305,300,000
2012 Subordinate Series B-1	5/4/2012	1.42%	12/20/2044	Monthly	1 month LIBOR + 120 basis points	19,500,000
						<u>\$ 904,483,000</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)**

**Additional Information on Series 2005 – 2006 Bonds**

**2005 Series B Student Loan Revenue Bonds**

The 2005 Series B Bonds expect a principal balance reduction schedule as follows:

**2005 B Senior Bonds**

Expected Principal Reduction <u>Date</u>	Expected Principal Reduction <u>Amount</u>
September 20, 2016	\$ 2,884,000
December 20, 2016	2,850,000
March 20, 2017	2,818,000
June 20, 2017	<u>2,776,000</u>
Total year ended June 30, 2017	<u>\$ 11,328,000</u>

Subsequent Years ended

June 30,

2018	\$ 10,740,000
2019	10,264,000
2020	9,741,000
2021	1,773,000

**2006 Series A Student Loan Revenue Bonds**

The 2006 Series A Bonds expect a principal balance reduction schedule as follows:

**2006 A Senior Bonds**

Expected Principal Reduction <u>Date</u>	Expected Principal Reduction <u>Amount</u>
September 20, 2016	\$ 6,228,000
December 20, 2016	6,166,000
March 20, 2017	6,005,000
June 20, 2017	<u>5,672,000</u>
Total Year ended June 30, 2017	<u>\$ 24,071,000</u>

Subsequent Years ended June 30,

2018	\$ 2,109,000
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MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)**

**Additional Information on Series 2012 Bonds**

The 2012 Series A1, A2, A3 and B1 Student Loan Revenue Bonds, issued May 4, 2012, were taxable issues with the proceeds used to purchase loans from the other financings to provide funds to retire all outstanding bond issues of the indenture except the 2005 Series B, the 2006 Series A bonds, and a portion of the 2006 Series C bonds as well as to purchase an external loan portfolio. See Redemptions section below for details. The Series 2012-A2 and Series 2012-A3 were issued at a discount of \$8,701,565 and \$22,924,281, respectively. A pro-rated portion of the bond discount is written off as the bonds associated bond discount are paid off early. The loss on the early redemption of Series 2012-A2 was \$438,876 in the year ended June 30, 2016, which represents an acceleration of the discount amortization.

MHESAC owns \$19,500,000 of the 2012 series subordinate bonds as an investment and this amount is eliminated from the financial statements.

**Series 2012 –A1 Student Loan Revenue Bonds**

The Series 2012 A-1 Bonds were fully redeemed in the year ended June 20, 2014.

**Series 2012 –A2 Student Loan Revenue Bonds**

The Series 2012-A2 Bonds expect a principal balance reduction schedule as follows:

**Series 2012-A2 Senior Bonds**

Expected Principal Reduction Date	Expected Principal Reduction Amount
July 20, 2016	\$ 9,247,000
August 20, 2016	222,000
September 20, 2016	10,196,000
October 20, 2016	6,657,000
November 20, 2016	45,000
December 20, 2016	9,905,000
January 20, 2017	5,901,000
February 20, 2017	-
March 20, 2017	9,421,000
April 20, 2017	5,862,000
May 20, 2017	45,000
June 20, 2017	<u>9,401,000</u>
Total Year ended June 30, 2017	<u>\$ 66,902,000</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)**

**Additional Information on Series 2012 Bonds (Continued)**

**Series 2012 –A2 Student Loan Revenue Bonds (Continued)**

The Series 2012-A2 Bonds expect a principal balance reduction schedule as follows:

**Series 2012-A2 Senior Bonds (Continued)**

Expected Principal Reduction Date <u>Subsequent Years ended June 30,</u>	Expected Principal Reduction <u>Amount</u>
2018	\$ 45,918,000
2019	49,053,000
2020	49,660,000
2021	58,023,000
2022	60,273,000
2023	60,835,000
2024	61,527,000
2025	39,466,000

The anticipated principal reduction amount for future periods includes \$426,956,578 in carry over principal reduction which would have to be paid before any early or special redemptions could be completed on the 2005 or 2006 bonds.

**Series 2012 –A3 Student Loan Revenue Bonds**

The Series 2012-A3 Bonds expect a principal balance reduction schedule as follows:

**Series 2012-A3 Senior Bonds**

Expected Principal Reduction Date <u>Years ended June 30,</u>	Expected Principal Reduction <u>Amount</u>
2025	\$ 11,408,000
2026	56,803,000
2027	54,218,000
2028	51,455,000
2029	52,086,000
2030	47,390,000
2031	31,940,000

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)**

**Retirements**

During the year ended June 30, 2016, the Corporation had targeted payments and scheduled redemptions of student loan revenue bonds. These redemptions are summarized in the tables below:

**Scheduled Redemptions**

<u>Bond Series</u>	<u>Redemption Date</u>	<u>Redemption Amount</u>
2005 Series B	09/20/2015	\$ 3,029,000
2006 Series A	09/20/2015	6,910,000
2005 Series B	12/20/2015	2,989,000
2006 Series A	12/20/2015	6,934,000
2005 Series B	03/20/2016	2,954,000
2006 Series A	03/20/2016	6,809,000
2005 Series B	06/20/2016	2,919,000
2006 Series A	06/20/2016	6,639,000
2012 Series A2	07/20/2015	559,000
2012 Series A2	08/20/2015	10,133,000
2012 Series A2	09/20/2015	6,904,000
2012 Series A2	10/20/2015	596,000
2012 Series A2	11/20/2015	10,020,000
2012 Series A2	12/20/2015	5,203,000
2012 Series A2	01/20/2016	713,000
2012 Series A2	02/20/2016	6,706,000
2012 Series A2	03/20/2016	8,504,000
2012 Series A2	04/20/2016	2,632,000
2012 Series A2	05/20/2016	7,024,000
2012 Series A2	06/20/2016	9,284,000

**Summary of Maturities**

The following is a summary of stated maturities on long-term debt. Interest is calculated using the average bond interest rate since bond issuance dates:

Year Ending <u>June 30</u>	Revenue Bonds <u>Payable</u>
2017	\$ 102,301,000
2018	58,767,000
2019	59,317,000
2020	59,401,000
2021	59,796,000
Thereafter	<u>564,901,000</u>
Total	<u>\$ 904,483,000</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
 June 30, 2016

**NOTE 6. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)**

**Compliance**

The bond indenture contains several covenants. These covenants include minimum reserve requirements, restrictions and limitations related to administrative expenses, and requirements for the purchase of educational loans. The Corporation is substantially in compliance with the covenants of the bond indenture outstanding at June 30, 2016.

Per the indenture, when the average of the Monthly Senior Trigger Percentage on each of the 6 months preceding monthly payment dates is less than 101.45% or if the average of the Monthly Subordinate Trigger Percentage on each of the 6 monthly payment date is less than 90.00%, then no interest will be paid to the subordinate bondholders. In January and February of 2013, the trigger percentages were not met. Interest is accrued monthly using One-Month LIBOR plus 1.2%, until all bonds are paid. The amount of carryover interest in the 2006C subordinate and the 2012 B subordinate at June 30, 2016, is \$45,828 and \$49,647, respectively.

**Bond Ratings**

As of June 30, 2016, all outstanding MHESAC Senior bonds are rated AAA by Fitch Ratings and the 2012-A2 bonds are rated AAA by Standard & Poor's while the 2012-A3 bonds are rated AA+ by Standard & Poor's Ratings Services. The 2005B and 2006A bonds are also rated Aaa by Moody's. The outstanding subordinate bonds are unrated.

**NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS**

GAAP requires disclosure of estimated fair values for other financial instruments recognized at amounts other than fair value and the methods used to determine those values. Those values and methodology used to derive them are as follows at June 30, 2016:

	<b><u>Carrying Amount</u></b>	<b><u>Fair Value</u></b>
Financial assets:		
Cash and cash equivalents	\$ 31,683,398	\$ 31,683,398
Interest receivable	14,805,763	14,805,763
Certificates of deposit	1,501,995	1,501,995
Educational loans receivable	<u>917,549,731</u>	<u>904,324,736</u>
Total financial assets	<u>\$ 965,540,887</u>	<u>\$ 952,315,892</u>
Financial liabilities:		
Interest payable	\$ 428,421	\$ 428,421
Educational bonds payable	<u>885,000,565</u>	<u>889,155,528</u>
Total financial liabilities	<u>\$ 885,428,986</u>	<u>\$ 889,583,949</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

The following is a description of the methods used to estimate the above fair values:

**Cash and Cash Equivalents**

The carrying amount for cash and cash equivalents is considered to approximate fair value at June 30, 2016.

**Interest Receivable and Payable**

The carrying amounts of interest receivable and payable are considered to approximate fair value at June 30, 2016, given their short-term nature.

**Investments – Certificates of Deposit and Corporate Issues**

The carrying amount of certificates is considered to approximate fair value.

**Educational Loans Receivable**

The fair value was estimated by discounting the future cash flows using current rates of return on similar assets (market approach). A number of significant inputs into the models are internally derived and not observable to market participants.

**Educational Bonds Payable**

The fair value of the Corporation's floating rate senior and subordinate Educational Loan Revenue Bonds is based on the brokered market for those bonds at June 30, 2016 (market approach).

**NOTE 8. COMMITMENTS AND CONTINGENCIES**

**Management and Servicing Agreements**

MHESAC has entered into management and servicing agreements with Student Assistance Foundation of Montana (SAF). SAF will provide portfolio servicing for a term equal to the life of each of MHESAC's related financings.

The cost of these services will be an amount equal to the allocable cost incurred by SAF in performing its duties and obligations under the agreements plus, for the period prior to February 1, 2003, fifteen percent of those costs. The servicing contract is for the life of the outstanding bonds.

For each successive three-year period, the mark-up percentage of such costs will be mutually agreed upon by MHESAC and SAF, but in no event will it be less than five percent. For the three year period beginning July 1, 2012, MHESAC and SAF agreed to continue the mark-up percentage at fifteen percent along with an efficiency incentive to provide a cost savings sharing opportunity and a maximum based on a percentage of the weighted average principal balance. The same terms were extended to December 31, 2016.



MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
June 30, 2016

**NOTE 8. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

**Management and Servicing Agreements (Continued)**

By contract, the fees are payable in advance for each month. Therefore, an estimate is made of anticipated cost levels and SAF bills MHESAC on that basis with a final adjustment to the advance billing based on actual expenses incurred. During the year ended June 30, 2016, SAF billed MHESAC \$9,537,574. At June 30, 2016, the reconciliation for billed and actual costs resulted in a balance payable by MHESAC of \$442,048.

**Supplemental Indenture**

As part of the Nineteenth Supplemental Indenture of Trust executed on July 15, 2011, the indenture trustee was appointed as back-up administrator of MHESAC in the event Student Assistance Foundation of Montana (SAF) is unable to perform its administrative duties. As back-up administrator the trustee will be entitled to a back-up administrator fee. SAF remains the trust administrator and servicer.

**NOTE 9. SUBSEQUENT EVENTS**

**Programs and Endowment**

Effective July 1, 2016, MHESAC has accepted responsibility for the governance and direction of all public purpose programs previously delivered by SAF with the exception of the FES grant. SAF will manage and administer, under contract on behalf of MHESAC, the public purpose charitable programs previously conducted directly by SAF.

In July 2016, MHESAC received a donation from SAF of the SAF board designated endowment. This change is also related to MHESAC taking over governance of the public purpose programs SAF had at June 30, 2016.

**Management and Servicing Agreements**

MHESAC made a decision in June 2016, to have SAF, as master servicer, outsource the servicing of MHESAC's portfolio.

**Other**

Management has evaluated subsequent events through September 15, 2016, the date which the financial statements were available for issue and did not identify any further events to disclose.

ACCOMPANYING INFORMATION

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 COMBINING SCHEDULE OF FINANCIAL POSITION UNDER BOND INDENTURES  
 June 30, 2016  
 (expressed in thousands)

	2005 REVENUE BONDS	2006-1 REVENUE BONDS	2012 REVENUE BONDS	GRAND TOTAL
<b>ASSETS</b>				
Cash and cash equivalents	\$ 3,062	\$ 6,400	\$ 12,366	\$ 21,828
Educational loans receivable, net	105,908	130,468	660,597	896,973
Accrued interest receivable	764	1,047	12,628	14,439
Inter-fund Activity	(32,091)	(60,117)	92,206	(2)
Prepaid costs, net	1	1	22	24
Other assets	30	65	266	361
 Total assets	 \$ 77,674	 \$ 77,864	 \$ 778,085	 \$ 933,623
 <b>LIABILITIES AND NET ASSETS</b>				
<b>LIABILITIES</b>				
Accounts payable and accrued expenses	\$ 124	\$ 179	\$ 3,465	\$ 3,768
Accrued interest payable	10	6	472	488
Educational loan revenue bonds payable	43,846	44,180	796,975	885,001
Total liabilities	43,980	44,365	800,912	889,257
 <b>NET ASSETS</b>				
Unrestricted	33,694	33,499	(22,827)	44,366
 Total liabilities and net assets	 \$ 77,674	 \$ 77,864	 \$ 778,085	 \$ 933,623

See Independent Auditor's Report.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION  
 COMBINING SCHEDULE OF ACTIVITIES UNDER BOND INDENTURES  
 Year Ended June 30, 2016  
 (expressed in thousands)

	<u>2005</u> REVENUE BONDS	<u>2006-1</u> REVENUE BONDS	<u>2012</u> REVENUE BONDS	<u>GRAND</u> TOTAL
UNRESTRICTED NET ASSETS				
Revenue and Gains				
Investment income	\$ 7	\$ 14	\$ 35	\$ 56
Revenue and support				
Interest on educational loan	3,650	4,126	21,153	28,929
Loss on redemption of bonds	-	-	(439)	(439)
Gain on purchase of loans	-	-	4	4
Total unrestricted revenue and gains	<u>3,657</u>	<u>4,140</u>	<u>20,753</u>	<u>28,550</u>
Operating Expenses				
Bond interest	298	232	14,459	14,989
Servicing fees	693	856	4,378	5,927
Trustee fees	7	12	119	138
Surveillance fees	2	3	33	38
Listing fees	9	7	-	16
Borrower rebates	-	-	102	102
Consolidation loan fees	1,170	1,439	5,386	7,995
Uncollectible accounts	<u>(36)</u>	<u>(34)</u>	<u>(44)</u>	<u>(114)</u>
Total operating expenses	<u>2,143</u>	<u>2,515</u>	<u>24,433</u>	<u>29,091</u>
General and administrative expense				
Management fee	<u>24</u>	<u>30</u>	<u>151</u>	<u>205</u>
Total general and administrative expenses	<u>24</u>	<u>30</u>	<u>151</u>	<u>205</u>
Change in net assets	1,490	1,595	(3,831)	(746)
NET ASSETS				
BEGINNING OF YEAR	<u>32,204</u>	<u>31,904</u>	<u>(18,996)</u>	<u>45,112</u>
END OF YEAR	<u>\$ 33,694</u>	<u>\$ 33,499</u>	<u>\$ (22,827)</u>	<u>\$ 44,366</u>

See Independent Auditor's Report.