

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, 2018

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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) (a nonprofit organization), which comprise the statement of financial position as of June 30, 2018, and the related statements of activities, functional expenses, 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 opinion.

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, 2018, 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 2017 financial statements, and our report dated September 27, 2017 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, 2017, 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 financial position under bond indentures, combining schedule of activities under bond indentures, and schedule of Reach Higher Montana Activity on pages 35 through 37 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 on pages 3 through 7, 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.



Helena, Montana
September 11, 2018

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S FINANCIAL ANALYSIS
Year Ended June 30, 2018 and Comparative Totals for June 30, 2017

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, 2018 and 2017. 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 is supported entirely through earnings on the student loans that it owns. MHESAC's current activities include the Federal Family Education Loan Program (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. In July of 2016, MHESAC took on the oversight and funding for the outreach, grant, and scholarship activity previously delivered by Student Assistance Foundation (SAF) and has rebranded those programs as Reach Higher Montana.

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; the statement of functional expenses, which is a new statement as part of MHESAC's early adoption of new not-for-profit reporting standards; 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 currently 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 and a board-restricted endowment. 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 held 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. The board-restricted endowment arose from the contribution of the SAF endowment to MHESAC to use for future programs. Although it came with no restrictions from SAF, the MHESAC board has restricted its use to public benefit activities.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)
Year Ended June 30, 2018 and Comparative Totals for June 30, 2017

Financial Position Summary

Following is an analysis of MHESAC's financial position at June 30, 2018, with comparative information at June 30, 2017 (expressed in thousands):

Assets	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 27,366	\$ 24,955
Educational loans receivable, net	704,416	811,681
Other assets	23,961	22,930
Total Assets	<u>\$ 755,743</u>	<u>\$ 859,566</u>
Liabilities and Net Assets		
Current liabilities	84,737	89,374
Long term debt and obligations	<u>582,460</u>	<u>678,752</u>
Total Liabilities	<u>667,197</u>	<u>768,126</u>
Net assets:		
Escrow/Trust	53,710	55,366
General Fund	34,185	35,426
Board-designated endowment	<u>651</u>	<u>648</u>
Total net assets	<u>88,546</u>	<u>91,440</u>
Total liabilities and net assets	<u>\$ 755,743</u>	<u>\$ 859,566</u>

At June 30, 2018, MHESAC had cash and cash equivalents of over \$27.3 million of which approximately \$19.3 million is limited as to use under the bond indenture or the escrow agreement; another \$651,000 is board restricted and the remaining \$7.4 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 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. MHESAC believes that the cash position is sufficient to satisfy all operating needs during the next operating cycle and the structured cash flow from the indenture will be sufficient to meet future needs beyond the next fiscal year.

The primary asset, the FFELP student loan portfolio, is made up of different loan types which each have different returns based on a spread to one-month LIBOR. FFELP loans are subject to a guarantee of 97 – 100% depending on the date the loan was originated. Most of the loans in the MHESAC portfolio are guaranteed at 98%. What this means is that if a borrower defaults on their loan, MHESAC will be reimbursed by a guarantor for 97 – 100% of the loan principal and accrued borrower interest, providing that all required due diligence to attempt to collect the loan was followed by the servicer. MHESAC carries a reserve for bad debt to manage the risk of the unguaranteed amount should a loan default.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)
Year Ended June 30, 2018 and Comparative Totals for June 30, 2017

Financial Position Summary (Continued)

During the fiscal year MHESAC decreased the reserve for bad debts which reflects our experience that default rates are holding very steady and also reflects the fact that there is 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 \$506,810 to \$470,799. There is also a discount for student loan purchase of \$34,444 that is also netted against the receivable for financial statement reconciliation.

Results of Operations Summary

MHESAC is reporting a negative change in net assets of \$2,894,599 for the fiscal year ended June 30, 2018. Please see the following recap of operating revenue and expenses (expressed in thousands):

	<u>2018</u>	<u>2017</u>
Revenue	\$ 30,021	\$ 29,497
Expenses	<u>32,915</u>	<u>33,415</u>
Change in net assets	(2,894)	(3,918)
Net assets, beginning of year	<u>91,440</u>	<u>95,358</u>
Net assets, end of year	<u>\$ 88,546</u>	<u>\$ 91,440</u>

The following is an overview of significant changes in financial data from FY17 to FY18:

- Cash and equivalents increased by \$2,411,000, most of which is in the unrestricted general fund cash balances.
- Net student loan receivables decreased by \$107,265,000, a pace that is similar to the previous year.
- Debt consisting of bonds outstanding decreased by \$100,047,000, also on a pace that is similar to the previous year.
- MHESAC's net assets decreased by \$2,894,000
- Total operating revenues increased by \$524,000
- Total expenses decreased by \$500,000

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. Although bonds outstanding decreased significantly during the year, bond interest rose by \$3,944,000 (24%) due to the increase in the relevant LIBOR index rates on the variable bonds which is the index to which the MHESAC bonds are tied. The flip side to the rate increase is that although student loans receivable decreased by 13.2% during the year, income on educational loans actually increased by 3.4%. The decrease in total costs is reflective of the change in the servicing arrangement in mid FY17. As a subset of total expenses, servicing and management fees decreased by \$3,289,000 from the prior year.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)
Year Ended June 30, 2018 and Comparative Totals for June 30, 2017

Results of Operations Summary (Continued)

The indenture is structured to survive the life of the bonds and the expected continued rise in future interest rates. Additionally, MHESAC incurred costs in FY18 for the Reach Higher Montana initiatives, that began the prior year, in the amount of \$2,151,966.

The expense line for bond interest includes \$2,136,438 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 \$221,884 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 2018 and 2017. At the beginning of the year, the one-month LIBOR rate was 1.2239% and at the end of the year it was 2.0903%. As a result, interest earned on student loans was higher in fiscal year 2018 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 in its general fund.

The floating rate notes in Series 2005B 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S FINANCIAL ANALYSIS (CONTINUED)
Year Ended June 30, 2018 and Comparative Totals for June 30, 2017

Long-term Debt Activity (Continued)

In the fiscal year that ended June 30, 2018, MHESAC redeemed outstanding bonds with all cash available and allowable by the indenture through scheduled and/or targeted redemptions. Redemptions made totaled \$102,405,000. An analysis of the change to bonds outstanding follows (including \$19,500,000 internally held bonds eliminated in the statement of financial position):

	<u>Current Portion</u>	<u>Long-term Portion</u>
Net bonds outstanding at 7/01/17	\$ 85,970,000	\$ 698,251,615
Scheduled, targeted payments of 2005, 2006 and 2012 Series bonds	(102,405,000)	
Amortization of bond discount	-	2,358,322
Reclassification to current	<u>98,650,000</u>	<u>(98,650,000)</u>
Net bonds outstanding at 6/30/18	<u>\$ 82,215,000</u>	<u>\$ 601,959,937</u>

FINANCIAL STATEMENTS

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF FINANCIAL POSITION
June 30, 2018 with Comparative Totals for 2017
(expressed in thousands)

	<u>2018</u>	<u>2017</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,401	\$ 5,004
Investments	249	1,248
Accrued interest receivable	122	170
Educational loans receivable, net	771	1,117
Prepaid costs, net of accumulated amortization	46	66
Other assets	149	198
Total Current Assets	<u>8,738</u>	<u>7,803</u>
RESTRICTED ASSETS, CURRENT		
Cash and cash equivalents	19,314	19,303
Accrued interest receivable	14,983	14,372
Educational loans receivable, net	70,785	81,638
Prepaid costs, net of accumulated amortization	25	26
Other assets	1,039	1,205
Total Restricted Assets, Current	<u>106,146</u>	<u>116,544</u>
NON-CURRENT ASSETS		
Educational loans receivable, net	<u>6,081</u>	<u>8,253</u>
Total Non-Current Assets	<u>6,081</u>	<u>8,253</u>
RESTRICTED ASSETS, NON-CURRENT		
Educational loans receivable, net	626,779	720,673
Prepaid servicing fees	7,348	5,645
Endowment cash and cash equivalents	651	648
Total Restricted Assets, Non-Current	<u>634,778</u>	<u>726,966</u>
TOTAL ASSETS	<u>\$ 755,743</u>	<u>\$ 859,566</u>

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, 2018 with Comparative Totals for 2017
(expressed in thousands)

	<u>2018</u>	<u>2017</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 1,728	\$ 2,704
Accrued interest payable	689	622
Educational loan revenue bonds payable - current portion	82,215	85,970
Funds held in trust	25	4
Grant Program liability	80	74
Total Current Liabilities	<u>84,737</u>	<u>89,374</u>
LONG-TERM LIABILITIES		
Educational loan revenue bonds payable, net	<u>582,460</u>	<u>678,752</u>
Total Long-Term Liabilities	<u>582,460</u>	<u>678,752</u>
Total Liabilities	<u>667,197</u>	<u>768,126</u>
NET ASSETS		
Without donor restrictions		
Escrow/Trust	53,710	55,366
General Fund	34,185	35,426
Board-designated endowment	651	648
Total net assets	<u>88,546</u>	<u>91,440</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 755,743</u>	<u>\$ 859,566</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, 2018 with Comparative Totals for 2017
(expressed in thousands)

	<u>2018</u>	<u>2017</u>
Revenue and Support		
Investment income	149	46
Interest on endowment	3	2
Unrealized gain on fair mkt valuation	1	(4)
Interest on educational loans	29,791	28,808
Loss on early redemption of bonds	(222)	(304)
Gain on purchase of loans	17	7
Contributions and grants	<u>266</u>	<u>893</u>
	30,005	29,448
Net assets released from donor restrictions	<u>16</u>	<u>49</u>
Total revenue and support without donor restrictions	<u>30,021</u>	<u>29,497</u>
 Program Operating Expenses		
Student loan operations	30,605	31,073
Grants and public purpose program	<u>1,806</u>	<u>2,000</u>
Total program operating expenses	<u>32,411</u>	33,073
 Fundraising expenses	1	9
General and Administrative Expenses	<u>503</u>	<u>333</u>
Total expenses	<u>32,915</u>	<u>33,415</u>
Change in net assets without donor restrictions	<u>(2,894)</u>	<u>(3,918)</u>
 NET ASSETS RELEASED FROM DONOR RESTRICTION		
Revenue and support:		
Contributions with donor restrictions	16	49
Net assets released from donor restrictions	<u>(16)</u>	<u>(49)</u>
	<u>-</u>	<u>-</u>
Change in net assets without donor restrictions	(2,894)	(3,918)
Net assets without donor restrictions at the beginning of the year	<u>91,440</u>	<u>95,358</u>
Net assets without donor restrictions at the end of the year	<u>\$ 88,546</u>	<u>\$ 91,440</u>

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended June 30, 2018
(expressed in thousands)

	<u>Program Services</u>			<u>Supporting Activities</u>		<u>Total</u>
	<u>Student Loan Operations</u>	<u>Grants and Public Purpose Program</u>	<u>Total Programs</u>	<u>Management & General</u>	<u>Fundraising</u>	
Advertising expense	\$ -	\$ 58	\$ 58	\$ -	\$ -	\$ 58
Board & officer expense	-	-	-	17	-	17
Bond Interest	20,622	-	20,622	-	-	20,622
Borrower rebate expense	75	-	75	-	-	75
Computer equipment, supplies and software	-	3	3	-	1	4
Consolidation loan fees	6,528	-	6,528	-	-	6,528
Contract labor & services	-	928	928	271	-	1,199
Depreciation & leasehold amortization	-	28	28	-	-	28
Dues and subscriptions	-	15	15	29	-	44
Grants, scholarships & other	-	373	373	-	-	373
Insurance	-	33	33	21	-	54
Listing fees	4	-	4	-	-	4
Mail and courier	-	4	4	-	-	4
Operating lease payments	-	27	27	-	-	27
Other costs	-	8	8	61	-	69
Printing	-	18	18	-	-	18
Professional services	-	33	33	104	-	137
Promotion and event costs	-	115	115	-	-	115
Rent	-	5	5	-	-	5
Servicing fees	3,229	-	3,229	-	-	3,229
Staff travel and training	-	123	123	-	-	123
Supplies and copier	-	8	8	-	-	8
Surveillance fees	37	-	37	-	-	37
Telecommunications & utilities	-	27	27	-	-	27
Trustee fee	113	-	113	-	-	113
Uncollectible account exp	(3)	-	(3)	-	-	(3)
Total expenses by function included in the expense section on the statement of activities	<u>\$ 30,605</u>	<u>\$ 1,806</u>	<u>\$ 32,411</u>	<u>\$ 503</u>	<u>\$ 1</u>	<u>\$ 32,915</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, 2018 with Comparative Totals for 2017
(expressed in thousands)

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received on student loans	\$ 18,879	\$ 15,918
Interest received on investments	753	480
Bond and note interest paid	(19,011)	(14,650)
Bond fees paid	(101)	(156)
Loan fees paid	(6,593)	(7,326)
Contracted management & servicing fees paid	(4,863)	(12,611)
Strategic planning fees paid	(98)	(130)
Administrative expenses paid	(60)	(62)
Grant and public purpose program paid	(1,836)	(1,265)
Net cash flows from operating activities	<u>(12,930)</u>	<u>(19,802)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of educational loans	(1,561)	(3,502)
Repayments of educational loans	118,308	119,770
Proceeds from sale of investments	999	254
Net cash flows from investing activities	<u>117,746</u>	<u>116,522</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Repayment of bonds	<u>(102,405)</u>	<u>(103,448)</u>
Net cash flows from financing activities	<u>(102,405)</u>	<u>(103,448)</u>
Net change in cash and equivalents	2,411	(6,728)
Cash and cash equivalents, beginning of year	<u>24,955</u>	<u>31,683</u>
Cash and cash equivalents, end of year	<u>\$ 27,366</u>	<u>\$ 24,955</u>
A reconciliation of cash and cash equivalents as shown on the balance sheet for MHESAC follows:		
Cash and cash equivalents	\$ 7,401	\$ 5,004
Restricted cash and cash equivalents	<u>19,965</u>	<u>19,951</u>
Cash and cash equivalents	<u>\$ 27,366</u>	<u>\$ 24,955</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, 2018

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) provide services for MHESAC's Reach Higher Montana (RHM) Initiative and arrange and perform the delivery of the programs under the initiative.

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 has been necessary in the past. On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. Included in this bill was a provision that specified that amounts incurred for certain qualified transportation benefits, including qualified parking, are now not deductible, even by not-for-profits. The RHM offices are located in an area where parking is not free and the company has provided parking passes to the contract SAF employees that work at that site. This amount becomes subject to unrelated business income tax. MHESAC has accrued \$378 in income tax expense for the year ended June 30, 2018.

Basis of Presentation

The financial statements are presented in accordance with accounting principles generally accepted in the United States of America (GAAP) as codified by the Financial Accounting Standards Board (FASB).

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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

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 two classes: net assets without donor restrictions and net assets with donor restrictions. The net assets are reported as follows:

Net assets without donor restrictions – Net assets that are not subject to donor-imposed stipulations and may be expended for any purpose in performing the primary objectives of the organization. These net assets may be used at the discretion of MHESAC's management and the board of directors.

Net assets with donor restrictions – Net assets subject to donor-imposed stipulations. Some donor restrictions are temporary in nature; those restrictions will be met by actions of MHESAC or by the passage of time. Other donor restrictions are perpetual in nature, where by the donor has stipulated the funds be maintained in perpetuity.

Donor restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets are reclassified from net assets with donor restrictions to net assets without donor restrictions in the statement of activities. The Corporation had no net assets with donor restrictions at June 30, 2018.

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.

Investments

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2018, rebates of \$6,002,222 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 6 for details on Education Loan Receivable and Allowance for Losses).

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

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 \$4,967,202 net of an allowance for uncollectible accounts of \$8,076. At June 30, 2018, total assets of \$11,804,934 less associated liabilities of \$23,124 equal \$11,781,810, the portion of unrestricted Escrow/Trust net assets related to the assets held in escrow.

In addition to the escrow funds, MHESAC has prepaid for servicing by funding an escrow account at SAF. This account was set up during the fiscal year that ended June 30, 2017. The purpose is to assure SAF, as Master Servicer, that funds are available in future years to satisfy the cost of servicing the MHESAC portfolio as it grows smaller through loan amortization. These funds are held in an escrow account by SAF with restriction as to future use. The prepaid servicing fees on the MHESAC books are restricted via legal agreements as to their use in the future. The amount of the prepaid fees at June 30, 2018 total \$7,347,384.

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 \$41,928,532. The Escrow and Trust related net assets, including the prepaid servicing fees total \$53,710,342.

Programs and Endowment

Effective July 1, 2016, MHESAC and SAF entered into an arrangement where MHESAC would take over the oversight and strategic direction for the public purpose benefit programs previously delivered by SAF, with the exception of one limited term grant which has since ended. MHESAC has rebranded these programs as Reach Higher Montana (RHM). 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. At June 30, 2018, the balance of the endowment was \$650,949.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contributions

Contributions are recorded as with donor restrictions or without donor restrictions, depending on the existence and/or nature of any donor restrictions.

Functional Allocation of Expenses

The costs of the Corporation's various programs and supporting services activities have been summarized on a functional basis in the statement of activities. The statement of functional expenses presents the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Fundraising Expenses

Fundraising expenses represent the Corporation's public benefit program solicitation efforts.

New Accounting Pronouncement

On August 18, 2016, FASB issued Accounting Standards update (ASU) 2016-14, Not-for-Profit Entities (Topic 958) – *Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. MHESAC has implemented ASU 2016-14 and has adjusted the presentation in these financial statements accordingly. MHESAC has elected not to restate 2017 for the functional allocation of expenses and liquidity disclosures, which this option is allowed in the year of implementation. The ASU has been applied retrospectively to all periods presented, which had no effect on the change in net assets or total assets previously reported.

NOTE 2. LIQUIDITY AND AVAILABILITY

The following financial assets are expected to be available to support the organization in the year ending June 30, 2019:

Cash and cash equivalents	\$ 7,400,948
Payments in transit	65,516
Accounts receivable	85,234
Accrued interest receivable	122,080
Educational loans receivable, net	770,303
Investments	249,199
	<u>\$ 8,693,280</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 2. LIQUIDITY AND AVAILABILITY (CONTINUED)

MHESAC's asset base is a result of its years as a provider of financial products to students participating in post-secondary education opportunities. Therefore, it follows that most assets are financial assets as the business requires little in the way of infrastructure because it outsources all of its management and servicing.

Almost 100% of assets are financial assets. However, 98% are held within an indenture of Trust and therefore available only to fulfill the requirements outlined in that Indenture. It is indeed important to note that the Trust has no reach into the non-restricted assets.

Of the non-trust assets, over 99% are financial assets and 56% are available to fund ongoing operations.

MHESAC's assets are currently very liquid. However, an investment committee has recently been formed with the goal of better allocating resources in the unrestricted assets for improved financial performance.

Funds available for usage flow into the accounts on a daily basis from student loan principal and interest payments. For the most part, funds received are adequate to cover daily operating costs.

MHESAC routinely forecasts financial activity 12 months in advance and monitors its liquidity quarterly as it completes each quarterly update of the rolling forecast.

NOTE 3. 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 two financial institutions and invests in certificates of deposits in one other institution. 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, 2018, the book balance was \$5,472,746 and bank balance amount of MHESAC deposits was \$5,496,397 with \$4,747,199 exceeding FDIC limits.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 4. FAIR VALUE MEASUREMENTS

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 to which the organization has access at the measurement date;
- 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, 2018, are comprised of certificates of deposit, for which cost approximates fair value. Certificates of deposit are not subject to investment categorization requirements.

NOTE 5. 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 5. INVESTMENTS (CONTINUED)

The following summarizes investments held at June 30, 2018:

<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
Ally Bank	<u>249,199</u>	1.15%	10/15/2018
	19,749,199		
Less intercompany holding:			
Wells Fargo MT Higher Ed 2012-B Security	<u>(19,500,000)</u>		
TOTAL INVESTMENTS	<u>\$ 249,199</u>		

NOTE 6. 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, 2018:

Student/interim status	\$135,145,317
Repayment status	<u>569,776,513</u>
Educational loans receivable	704,921,830
Allowance for uncollectible loans	(470,799)
Discount on loan purchase	<u>(34,444)</u>
Educational loans receivable, net	<u>\$704,416,587</u>

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, 2018

NOTE 6. 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 its 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, 2018.

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 360th 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, 2018, loans in the amount of \$5,904,509 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, 2018

NOTE 6. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES
(CONTINUED)

Allowance for Uncollectible Loans (Continued)

As of June 30, 2018, MHESAC held a loan portfolio of \$704,921,830. The average default rate for loans serviced by SAF resulted in a provision for uncollectible educational loans of \$470,799 for the year ended June 30, 2018.

Following is a reconciliation of the change in the allowance for uncollectible loans for the year ended June 30, 2018:

Balance, July 1, 2017	\$	506,810
Non-guaranteed write-offs		(33,328)
Adjustments per allowance policy		<u>(2,683)</u>
Balance, June 30, 2018	\$	<u>470,799</u>

There is also a discount for student loan purchase of \$34,444 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, 2018:

100% Guarantee	\$	747,004
98% Guarantee		416,756,842
97% Guarantee		287,417,984
Uninsured		-
TOTAL PORTFOLIO	\$	<u>704,921,830</u>

No changes were implemented in the accounting policies or methodologies during the year ended June 30, 2018, regarding calculation of the allowance for uncollectible loans.

NOTE 7. RELATED PARTY TRANSACTIONS

MHESAC has entered into agreements with SAF to provide management and master loan servicing to MHESAC. As master servicer, SAF has contracted with a third party sub-servicer to handle the day to day student loan servicing. SAF has two of its Board members in common with the Corporation's seven Board members.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 8. 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, 2017, net	\$ 784,221,615
Bond discount amortization during the year	2,136,438
Loss on early redemption of bonds	221,884
Bonds redeemed during the year	<u>(102,405,000)</u>
Bonds outstanding	684,174,937
Less: internal 2012 bond holding	<u>(19,500,000)</u>
Bonds outstanding at June 30, 2018, net	<u>\$ 664,674,937</u>

A description of significant terms and conditions of each Student Loan Revenue Bond issue outstanding at June 30, 2018, follows:

<u>Issue</u>	<u>Year End Interest Rate</u>	<u>Original Issue Amount</u>	<u>June 30, 2018</u>
Taxable Floating Rate Bonds:			
2005 Series B Bonds	2.445%	\$ 119,140,000	\$ 21,778,000
2006 Series C Bonds **	3.284%	30,000,000	18,000,000
2012 Series A-2 Bonds	3.084%	649,000,000	334,052,000
2012 Series A-3 Bonds	3.134%	305,300,000	305,300,000
2012 Series B-1 **	3.284%	<u>19,500,000</u>	<u>19,500,000</u>
Total Bonds		1,122,940,000	698,630,000
Less Discount		<u>(31,625,846)</u>	<u>(14,455,063)</u>
TOTAL BONDS		<u>\$1,091,314,154</u>	<u>\$ 684,174,937</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, 2018

NOTE 8. 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, 2018</u>
2005 Senior Series B	5/26/2005	2.05%	6/20/2030	Quarterly	3 month LIBOR + 12 basis points	\$ 21,778,000
2006 Subordinate Series C	5/3/2006	1.71%	12/20/2046	Monthly	1 month LIBOR + 120 basis points	18,000,000
2012 Senior Series A-2	5/4/2012	1.43%	5/20/2030	Monthly	1 month LIBOR + 100 basis points	334,052,000
2012 Senior Series A-3	5/4/2012	1.56%	7/20/2043	Monthly	1 month LIBOR + 105 basis points	305,300,000
2012 Subordinate Series B-1	5/4/2012	1.71%	12/20/2044	Monthly	1 month LIBOR + 120 basis points	<u>19,500,000</u>
						<u>\$ 698,630,000</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 8. 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

<u>Expected Principal Reduction Date</u>	<u>Expected Principal Reduction Amount</u>
September 20, 2018	\$ 2,610,000
December 20, 2018	2,580,000
March 20, 2019	2,551,000
June 20, 2019	<u>2,523,000</u>
Total year ended June 30, 2019	10,264,000
2020	9,741,000
2021	<u>1,773,000</u>
Total	<u>\$ 21,778,000</u>

2006 Series A Student Loan Revenue Bonds

The 2006 Series A Bonds were fully redeemed in the year ended June 20, 2018.

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 associated bond discount is written off as bonds are paid off early. The loss on the early redemption of Series 2012-A2 was \$221,884 in the year ended June 30, 2018, 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 8. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

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 <u>Date</u>	Expected Principal Reduction <u>Amount</u>
July 20, 2018	\$ 17,784,000
August 20, 2018	4,339,000
September 20, 2018	4,970,000
October 20, 2018	4,125,000
November 20, 2018	3,150,000
December 20, 2018	5,446,000
January 20, 2019	4,008,000
February 20, 2019	2,931,000
March 20, 2019	5,527,000
April 20, 2019	3,962,000
May 20, 2019	2,793,000
June 20, 2019	<u>5,290,000</u>
Total Year ended June 30, 2019	64,325,000
2020	64,953,000
2021	78,381,000
2022	73,980,000
2023	<u>52,413,000</u>
Total	<u>\$334,052,000</u>

The anticipated principal reduction amount for future periods includes \$334,052,000 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 8. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2012 Bonds (Continued)

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>
2023	\$ 13,573,000
2024	57,559,000
2025	51,710,000
2026	46,397,000
2027	42,201,000
2028	35,556,000
2029	29,937,000
2030	25,319,000
2031	<u>3,048,000</u>
Total	<u>\$ 305,300,000</u>

Series 2012 –B1 Student Loan Revenue Bonds

The Series 2012-B1 Bonds expect a principal balance reduction schedule as follows:

Series 2012-B1 Subordinate Bonds

Expected Principal Reduction Date <u>Years ended June 30,</u>	Expected Principal Reduction <u>Amount</u>
2031	\$ 18,539,000
2032	<u>961,000</u>
Total	<u>\$ 19,500,000</u>

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 8. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

2006 Series C Student Loan Revenue Bonds

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

Series 2006 C Subordinate Bonds

Expected Principal Reduction Date <u>Years ended June 30,</u>	Expected Principal Reduction <u>Amount</u>
2032	\$ 14,448,000
2033	<u>3,552,000</u>
Total	<u>\$ 18,000,000</u>

Retirements

During the year ended June 30, 2018, 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	09/20/2017	\$ 2,731,000
2006 Series A	09/20/2017	2,109,000
2005 Series B	12/20/2017	2,699,000
2005 Series B	03/20/2018	2,670,000
2005 Series B	06/20/2018	2,640,000
2012 Series A2	07/20/2017	3,221,000
2012 Series A2	08/20/2017	6,439,000
2012 Series A2	09/20/2017	8,188,000
2012 Series A2	10/20/2017	8,900,000
2012 Series A2	11/20/2017	6,523,000
2012 Series A2	12/20/2017	9,145,000
2012 Series A2	01/20/2018	5,095,000
2012 Series A2	02/20/2018	9,508,000
2012 Series A2	03/20/2018	8,810,000
2012 Series A2	04/20/2018	6,249,000
2012 Series A2	05/20/2018	6,644,000
2012 Series A2	06/20/2018	10,834,000

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 8. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Summary of Maturities

The following is a summary of stated maturities for the 2005 and 2006 bonds along with the expected maturities for the 2012 bonds. Interest is calculated using the average bond interest rate since bond issuance dates:

Year Ending <u>June 30</u>	Revenue Bonds <u>Payable</u>
2019	\$ 74,589,000
2020	74,694,000
2021	80,154,000
2022	73,980,000
2023	65,986,000
Thereafter	<u>329,227,000</u>
Total	<u>\$ 698,630,000</u>

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, 2018.

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, 2018, is \$47,877 and \$51,866, respectively.

Bond Ratings

As of June 30, 2018, 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 9. 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, 2018:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:		
Cash and cash equivalents	\$ 27,366,346	\$ 27,366,346
Interest receivable	15,104,377	15,104,377
Certificates of deposit	249,199	249,199
Educational loans receivable	<u>704,416,587</u>	<u>711,444,288</u>
Total financial assets	<u>\$747,136,509</u>	<u>\$ 754,164,210</u>
Financial liabilities:		
Interest payable	689,303	689,303
Educational bonds payable	<u>684,174,937</u>	<u>670,340,079</u>
Total financial liabilities	<u>\$684,864,240</u>	<u>\$671,029,382</u>

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, 2018.

Interest Receivable and Payable

The carrying amounts of interest receivable and payable are considered to approximate fair value at June 30, 2018, 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, 2018 (market approach).

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 10. COMMITMENTS AND CONTINGENCIES

Management and Servicing Agreements

MHESAC has entered into management and servicing agreements with SAF. SAF is the Master Servicer and has subcontracted with a third party servicer to provide the day to day servicing. SAF will continue to manage the MHESAC business via the management contract in place.

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 fifteen percent of those costs subject to certain minimums and maximums at different periods over the life of the contract. The servicing contract is for the life of the outstanding bonds.

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, 2018, SAF billed MHESAC \$4,945,165. At June 30, 2018, the reconciliation for billed and actual costs resulted in a balance payable by MHESAC of \$9,151.

Escrow Agreement

MHESAC has entered into an escrow agreement with SAF in order to assure there will be sufficient funds to pay future monthly management and servicing fees. SAF established an escrow account for the purpose of receiving and holding escrow property. Wells Fargo Bank was appointed as the escrow agent and is authorized and directed to hold and invest the escrow property. All interest and other earnings on the escrow property shall be deposited in the escrow account. The escrow is held as an asset by SAF.

Deposits made monthly into the escrow account represent the amount, if any, by which the monthly billing from SAF to MHESAC (at 60 basis points annually of the outstanding student loan portfolio) exceeds the actual allocated costs of SAF in performing its duties and obligations under the contracts for management and master servicing.

In September 2016, an initial deposit from MHESAC General Fund Escrow of \$4,976,034 was made into the escrow account. The deposit was a calculated amount based on cash flow projections from the MHESAC Indenture. The amount represents an initial balance that, when added to expected increases to the escrow in the coming years, will ensure sufficient funds to pay for servicing and management in future years when the MHESAC portfolio has amortized to the point where it no longer produces sufficient cash to cover its servicing and management obligations. During the year an additional \$1,702,175 was added to escrow from amounts collected from MHESAC in excess of the monthly management and servicing fees based on the allocated costs plus 15%.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Escrow Agreement (Continued)

At June 30, 2018, MHESAC's prepaid servicing fees balance was \$7,347,384. The prepaid will be reduced in future years when the cash available from MHESAC's Indenture is not sufficient to cover the cost of the contracts with SAF for master servicer and management services per the contracts between MHESAC and SAF.

Management and Support Agreement

On July 1, 2016, SAF entered into a management and support agreement with MHESAC for the MHESAC public purpose initiatives that have been branded as Reach Higher Montana. SAF will provide management services for MHESAC's Reach Higher Montana Initiative and will arrange and perform the delivery of the programs under the initiative. The cost of these services to deliver the programs is an amount equal to the allocable cost incurred by SAF in performing its duties and obligations under the agreement plus a mark-up of five percent of these costs.

During the year ended June 30, 2018, SAF billed MHESAC \$289,402 for management services and \$989,485 for program delivery of the Reach Higher Montana initiatives. The reconciliation for billed and actual management and program delivery resulted in a net balance payable to SAF of \$42,012.

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 master servicer.

NOTE 11. ENDOWMENT

In fiscal year 2017, the SAF Board-Designated Endowment was transferred, as an unrestricted donation, to MHESAC. The transfer was part of the Board's restructuring plan and is also related to MHESAC's subsequent governance of the public purpose programs SAF delivered up to June 30, 2016. The MHESAC Board subsequently designated the funds for additional programs that will enhance access to post-secondary education for Montana students and citizens in the future. MHESAC will be establishing a spending policy and related investment policy for the endowment funds in the future. Currently, it is held as cash and cash equivalents.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2018

NOTE 11. ENDOWMENT (CONTINUED)

The following describes the composition of net assets of the endowment as of June 30, 2018:

	Without Donor Restrictions	With Donor Restrictions	Total
Balance, June 30, 2017	\$ 647,605	\$ -	\$ 647,605
Investment interest	3,344	-	3,344
Balance, June 30, 2018	<u>\$ 650,949</u>	<u>\$ -</u>	<u>\$ 650,949</u>

NOTE 12. NET ASSETS

At June 30 net assets consist of the following:

Without donor restrictions:	<u>2018</u>
Escrow/Trust	\$ 53,710,342
General Fund	34,184,830
Board designated for endowment	650,949
Total net assets without donor restrictions	<u>\$ 88,546,121</u>

During the year ended June 30, 2018, donor restricted net assets received were released from donor restrictions as follows:

Expiration of donor restriction released by expenditure for:	<u>2018</u>
Reach Higher Montana Scholarships	\$ 25
ETV Foster Care Summit	16,342
Total net assets released from donor restrictions	<u>\$ 16,367</u>

NOTE 13. FUNCTIONALIZED EXPENSES

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, some expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated within student loan operations between financings are servicing fees, that are allocated according to relative student loan balances.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2018

NOTE 13. FUNCTIONALIZED EXPENSES (CONTINUED)

MHESAC's master servicer and RHM's programs delivery and administration provider, SAF, allocates its expenses in order to calculate the servicing fees, programs delivery fees and programs administration fees to MHESAC. The expenses that are allocated include rent and other expenses on a square footage basis; depreciation and other indirect expenses on a full-time equivalent basis; and salaries, benefits, payroll taxes, contract labor, professional services, office expenses, computer equipment, insurance, and other, which are allocated on the basis of estimates of time and effort by departments. Time and effort is based on a combination of time sheet project direct reporting when practical and a percentage estimate that is preassigned to each department and reviewed during forecasting for each business activity including administration. Once allocated, the expenses are marked up per the contract with SAF.

NOTE 14. GRANT ACTIVITY

Effective July 1, 2016, SAF transferred, and MHESAC accepted, responsibility for the governance and direction of most SAF public purpose programs. SAF will manage and administer under contract, on behalf of MHESAC, the public purpose charitable programs previously conducted directly by SAF.

The Chaffee grant education and training voucher program grant was transferred to MHESAC under Reach Higher Montana effective July 1, 2016. The grant provides for the delivery of Educational Training Vouchers (ETV) funds, development, and delivery of college and life skills prep program and promotion of the use of ETV and other financial aid resources. Revenue totaling \$282,430 was recognized in the year ended June 30, 2018 with related expenses of \$302,327.

NOTE 15. SUBSEQUENT EVENTS

Other

Management has evaluated subsequent events through September 11, 2018, the date which the financial statements were available for issue and did not identify any events to disclose.

SUPPLEMENTARY INFORMATION

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 COMBINING SCHEDULE OF FINANCIAL POSITION UNDER BOND INDENTURES
 June 30, 2018
 (expressed in thousands)

	2005 REVENUE BONDS	2012 REVENUE BONDS	GRAND TOTAL
ASSETS			
Cash and cash equivalents	\$ 2,790	\$ 14,795	\$ 17,585
Educational loans receivable, net	86,635	605,962	692,597
Accrued interest receivable	1,053	13,805	14,858
Inter-fund Activity	(31,884)	31,883	(1)
Prepaid costs, net	290	2,107	2,397
Other assets	34	997	1,031
Total assets	<u>\$ 58,918</u>	<u>\$ 669,549</u>	<u>\$ 728,467</u>
 LIABILITIES AND NET ASSETS			
LIABILITIES			
Accounts payable and accrued expenses	\$ 80	\$ 1,525	\$ 1,605
Accrued interest payable	16	744	760
Educational loan revenue bonds payable	21,778	662,397	684,175
Total liabilities	<u>21,874</u>	<u>664,666</u>	<u>686,540</u>
 NET ASSETS			
Without donor restrictions	37,044	4,883	41,927
Total liabilities and net assets	<u>\$ 58,918</u>	<u>\$ 669,549</u>	<u>\$ 728,467</u>

See Independent Auditor's Report.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 COMBINING SCHEDULE OF ACTIVITIES UNDER BOND INDENTURES
 Year Ended June 30, 2018
 (expressed in thousands)

	2005 REVENUE BONDS	2006-1 REVENUE BONDS	2012 REVENUE BONDS	GRAND TOTAL
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
NET ASSETS				
Revenue and Gains				
Investment income	\$ 27	\$ 7	\$ 141	\$ 175
Revenue and support				
Interest on educational loan	3,638	1,324	24,355	29,317
Loss on redemption of bonds	-	-	(222)	(222)
Gain on purchase of loans	-	-	17	17
Total revenue and gains	<u>3,665</u>	<u>1,331</u>	<u>24,291</u>	<u>29,287</u>
Operating Expenses				
Bond interest	490	7	20,733	21,230
Servicing fees	343	177	2,290	2,810
Legal fees	-	-	21	21
Trustee fees	5	3	103	111
Surveillance fees	1	-	36	37
Listing fees	3	-	1	4
Borrower rebates	-	-	72	72
Consolidation loan fees	964	305	5,204	6,473
Uncollectible accounts	(12)	(5)	12	(5)
Total operating expenses	<u>1,794</u>	<u>487</u>	<u>28,472</u>	<u>30,753</u>
Change in net assets	1,871	844	(4,181)	(1,466)
NET ASSETS				
BEGINNING OF YEAR	<u>35,176</u>	<u>35,388</u>	<u>(27,170)</u>	<u>43,394</u>
END OF YEAR	<u>\$ 37,047</u>	<u>\$ 36,232</u>	<u>\$ (31,351)</u>	<u>\$ 41,928</u>

See Independent Auditor's Report.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
SCHEDULE OF REACH HIGHER MONTANA ACTIVITY
For the Year Ended June 30, 2018
(expressed in thousands)

	<u>2018</u>	<u>2017</u>
Reach Higher Montana Programs Delivery		
Program delivery	\$ 702,826	\$ 706,421
Campus outreach		
Outreach staff & offices	510,510	494,942
Outreach programs		
Financial literacy & other programs	23,750	13,395
Foster Care Program	302,327	278,614
Montana College Access Network	15,474	20,336
RHM College Goal - FAFSA Completion	58,378	11,297
RHM rebranding	-	53,032
Grants awarded		
Access Grants for STEM Scholarships	-	210,500
Montana Chamber Foundation Envision 2026	10,000	10,000
Scholarships		
Reach Higher Montana Scholarships	75,000	75,000
Advisory Council Scholarships	3,000	-
Circle of Success Scholarships	-	28,500
High School Business Challenge	5,500	4,125
Jobs for Montana Graduates Scholarships	-	1,500
Miscellaneous scholarships	2,000	638
Youth Serve Montana	50,000	50,000
Sponsorships		
25 under 25	1,000	-
Bozeman Schools Foundation	1,500	1,500
Exploration Works	2,000	1,500
Governor's Office of Community Service	-	1,500
Grandstreet Theatre	3,000	-
Helena Education Foundation	10,000	8,500
Helena Family YMCA	2,000	1,000
Leadership Montana	2,500	2,500
Miscellaneous Sponsorships	7,254	7,400
Montana Association of Student Councils	-	1,000
Montana College Access Network	1,000	1,000
Montana Family, Career & Community Leaders of America	1,000	1,000
Montana HOSA-Future Health Professionals	1,000	-
Montana Non-Profit Association	1,000	3,000
Montana Post Secondary Educational Opportunity Council	10,000	10,000
Montana School Counselor Association	2,675	2,025
Serve Montana	1,500	-
	<u>\$ 1,806,194</u>	<u>\$ 2,000,225</u>

See Independent Auditor's Report.