

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, 2014

C O N T E N T S

INDEPENDENT AUDITOR'S REPORT1 and 2

MANAGEMENT'S DISCUSSION AND ANALYSIS3 to 7

FINANCIAL STATEMENTS

Statement of Net Position.....8 and 9

Statement of Revenue, Expense and Changes in Fund Net Position10

Statement of Cash Flows11 and 12

Notes to Financial Statements 13 through 31

ACCOMPANYING INFORMATION

Combining Schedule of Assets, Liabilities and Fund Net Position
Under Restricted Bond Indentures32

Combining Schedule of Revenue, Expense and Change in
Fund Net Position under Restricted Bond Indentures33

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying statement of net position of the Montana Higher Education Student Assistance Corporation (the Corporation) as of June 30, 2014, and the related statements of revenue, expense and changes in fund net position, and cash flows as and for the year then ended, and the related notes to the financial statements, which collectively comprise the Corporation's basic 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 an opinion 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, 2014, and the changes in its financial position 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 2013 financial statements, and our report dated September 13, 2013, 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, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Corporation's basic financial statements. The combining schedules of assets, liabilities and fund net position under restricted bond indentures and revenue, expense and change in fund net position under restricted bond indentures (the combining schedules) are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.



Helena, Montana
September 15, 2014

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2014 and Comparative Totals for June 30, 2013

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, 2014 and 2013. 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 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. As a not-for-profit entity that has the ability to issue tax-exempt debt, MHESAC is classified as a "governmental nonprofit" entity for accounting purposes.

Financial Reporting Methodology Overview

This annual report consists of MHESAC's basic financial statements and Management's Discussion and Analysis. As discussed in Note 1, Summary of Significant Accounting Policies, GASB 34 requires a discussion of results of operations and financial position and a presentation of financial statements in a manner similar to private business. MHESAC follows proprietary fund reporting. Accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

The basic financial statements include the statement of net position, which reports the assets owned by MHESAC, its liabilities or what it owes to others and total fund net position as of its fiscal year end; the statement of revenues, expenses and changes in fund net position, which reports the operating net income and change in fund net position; 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 MHESAC has both restricted and unrestricted assets and fund net position. Restricted refers to the assets and net position whose use is restricted by the bond indenture or escrow agreement. The restricted assets must be used in accordance with stipulations in the governing bond indenture or escrow agreement. They cannot be used for any other purpose. Unrestricted assets and fund net position are items that are not restricted in their use, located in what we call the general fund. These 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 DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2014 and Comparative Totals for June 30, 2013

Financial Position Summary

Following is an analysis of MHESAC's financial position at June 30, 2014 with comparative information at June 30, 2013 (000s omitted):

| Assets | <u>6/30/2014</u> | <u>6/30/2013</u> |
|--|-------------------------|-------------------------|
| Cash and cash equivalents | \$ 32,978 | \$ 37,711 |
| Investments | - | 600 |
| Educational loans receivable, net | 1,142,822 | 1,260,704 |
| Other assets | <u>16,965</u> | <u>17,026</u> |
| Total Assets | <u>\$ 1,192,765</u> | <u>\$ 1,316,041</u> |
| | | |
| Liabilities and Fund Net Position | | |
| Current liabilities | 128,254 | 408,032 |
| Long term debt and obligations | <u>961,302</u> | <u>801,247</u> |
| Total Liabilities | <u>1,089,556</u> | <u>1,209,279</u> |
| Fund Net position | | |
| Restricted fund net position | 69,569 | 73,545 |
| Unrestricted fund net position | <u>33,640</u> | <u>33,217</u> |
| Total Fund net position | <u>103,209</u> | <u>106,762</u> |
| Total liabilities and fund net position | <u>\$ 1,192,765</u> | <u>\$ 1,316,041</u> |

At June 30, 2014 MHESAC had cash and cash equivalents of over \$32.9 million of which approximately \$2.6 million is unrestricted and \$30.4 million is restricted under the bond indenture or escrow agreement. The cash equivalents in the restricted fund are 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, 2014 (gross loan amounts):

| | |
|---------------|------------------------|
| Stafford | \$ 250,240,395 |
| PLUS | 16,774,921 |
| Consolidation | 875,637,426 |
| Other | 169,711 |
| Total | <u>\$1,142,822,453</u> |

During the fiscal year MHESAC increased the reserve for bad debts which reflects a small change in exposure to bad debt due to slightly increased historical default rates. The reserve, which is netted against the student loans receivable for financial statement presentation increased from \$716,942 to \$735,602.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2014 and Comparative Totals for June 30, 2013

Results of Operations Summary

MHESAC is reporting operating loss of \$3,553,000 for the fiscal year ended June 30, 2014. Please see the following analysis of operating revenue and expense sources (000s omitted):

Operating Revenue Sources

| | FY Ended <u>06/30/14</u> | FY Ended <u>06/30/13</u> |
|---------------------------|-------------------------------------|-------------------------------------|
| Interest on investments | \$ 219 | \$ 300 |
| Interest on student loans | <u>34,691</u> | <u>41,455</u> |
| Total operating revenue | <u>34,910</u> | <u>41,755</u> |

Operating Expense Sources

| | | |
|---|--------------------------|--------------------------|
| Bond and note interest | 15,509 | 17,099 |
| Bond fees | 211 | 229 |
| Loan fees | 9,863 | 10,712 |
| Management & servicing cost | 12,848 | 13,611 |
| Other costs | <u>32</u> | <u>33</u> |
| Total operating expenses | <u>38,463</u> | <u>41,684</u> |
| Change in fund net position | (3,553) | 71 |
| Fund net position, beginning of year | <u>106,762</u> | <u>106,691</u> |
| Fund net position, end of year | <u>\$ 103,209</u> | <u>\$ 106,762</u> |

The following is an overview of changes in financial data from FY 13 to FY 14:

- Cash and equivalents decreased by \$4,733,000
- Net student loan receivables decreased by \$117,882,000
- Debt consisting of net bonds outstanding decreased by \$118,766,000
- MHESAC's net position decreased by \$3,553,000
- Total operating revenues decreased by \$6,845,000
- Total operating expenses increased by \$3,221,000

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 now structured to survive the life of the bonds and the expected rise in future interest rates. The results for fiscal year 2014 are indicative of what can be expected for the remainder of the life of the bond trust. The expense line for bond interest does include \$2,700,688 for bond discount amortization which is a non-cash expense item.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2014 and Comparative Totals for June 30, 2013

Results of Operations Summary (Continued)

Operating revenues from the student loans are variable in nature and were based on the one-month LIBOR rate during fiscal years 2014 and 2013. At the beginning of the year, the LIBOR rate was 0.1947% and at the end of the year it was 0.1552%. As a result, interest earned on student loans was slightly lower in fiscal year 2014 as compared to the previous year for two reasons: first, the return was lower due to the slight decrease in the index rate over the course of the year, and second due to 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 carry a AA+ rating from Standard & Poor's and a AAA rating by Fitch. 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 AA+ 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, 2014, MHESAC redeemed outstanding bonds with all cash available and allowable by the indenture through targeted redemptions. Scheduled redemptions made totaled \$121,466,000. An analysis of the change to bonds outstanding follows:

| | Current <u>Portion</u> | Long-term <u>Portion</u> |
|---|---------------------------|-----------------------------|
| Bonds outstanding at 7/01/13 | \$ 401,538,292 | \$ 849,321,708 |
| Scheduled, targeted payments of 2005, 2006 and 2012 Series bonds | (121,466,000) | - |
| Reclassification to current | <u>(157,355,292)</u> | <u>157,355,292</u> |
| Bonds outstanding at 6/30/14 | \$ 122,717,000 | \$ 1,006,677,000 |
| Unamortized bond discount | - | (25,874,664) |
| Net bonds outstanding | <u>\$ 122,717,000</u> | <u>\$ 980,802,336</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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2014 and Comparative Totals for June 30, 2013

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 2014, the 1-month LIBOR rate averaged 0.16% and the 90-day commercial paper rate averaged 0.12%. This resulted in a return on student loans that was 0.04% higher than if the election had not been made. Based on a simple average of the loans outstanding, this election resulted in approximately \$480,000 in additional loan return during fiscal year 2014.

FINANCIAL STATEMENTS

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF NET POSITION
June 30, 2014 with Comparative Totals for 2013
(expressed in thousands)

| | <u>2014</u> | <u>2013</u> |
|---|---------------------|---------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 2,553 | \$ 5,306 |
| Investments | - | 600 |
| Accrued interest receivable | 167 | 132 |
| Prepaid costs, net of accumulated amortization | 10 | 9 |
| Other assets | <u>15</u> | <u>144</u> |
| Total Current Assets | <u>2,745</u> | <u>6,191</u> |
| RESTRICTED ASSETS | | |
| Cash and cash equivalents | 30,425 | 32,405 |
| Educational loans receivable, net | 1,131,460 | 1,253,108 |
| Accrued interest receivable | 15,155 | 15,851 |
| Prepaid costs, net of accumulated amortization | 25 | 26 |
| Other Assets | <u>1,593</u> | <u>864</u> |
| Total Restricted Assets | <u>1,178,658</u> | <u>1,302,254</u> |
| OTHER ASSETS | | |
| Educational loans receivable, net | <u>11,362</u> | <u>7,596</u> |
| TOTAL ASSETS | <u>\$ 1,192,765</u> | <u>\$ 1,316,041</u> |

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF NET POSITION (CONTINUED)
June 30, 2014 with Comparative Totals for 2013
(expressed in thousands)

| | <u>2014</u> | <u>2013</u> |
|--|---------------------|---------------------|
| LIABILITIES AND FUND NET POSITION | | |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued expenses | \$ 5,133 | \$ 6,004 |
| Accrued interest payable | 404 | 490 |
| Educational loan revenue bonds payable - current portion | <u>122,717</u> | <u>401,538</u> |
| Total Current Liabilities | <u>128,254</u> | <u>408,032</u> |
| LONG-TERM DEBT | | |
| Educational loan revenue bonds payable | <u>961,302</u> | <u>801,247</u> |
| TOTAL LIABILITIES | <u>1,089,556</u> | <u>1,209,279</u> |
| FUND NET POSITION | | |
| Restricted fund net position | 69,569 | 73,545 |
| Unrestricted fund net position | <u>33,640</u> | <u>33,217</u> |
| Total Fund Net Position | <u>103,209</u> | <u>106,762</u> |
| TOTAL LIABILITIES AND FUND NET POSITION | <u>\$ 1,192,765</u> | <u>\$ 1,316,041</u> |

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF REVENUE, EXPENSE AND CHANGES IN FUND NET POSITION
June 30, 2014 with Comparative Totals for 2013
(expressed in thousands)

| | <u>2014</u> | <u>2013</u> |
|--|-------------------|-------------------|
| OPERATING REVENUE | | |
| Interest on investments and cash equivalents | \$ 219 | \$ 300 |
| Interest on educational loans (net of expense for uncollectible accounts of \$41,699 in 2013 and \$28,840 in 2014) | <u>34,691</u> | <u>41,455</u> |
| Total Operating Revenue | <u>34,910</u> | <u>41,755</u> |
| OPERATING EXPENSE | | |
| Financing expenses: | | |
| Bond and note interest | 15,509 | 17,099 |
| Bond fees | 211 | 229 |
| Loan fees | 9,863 | 10,712 |
| Contracted management fees | 2,440 | 2,585 |
| Contracted loan servicing fees | 10,408 | 11,026 |
| Administrative Expenses | <u>32</u> | <u>33</u> |
| Total Operating Expense | <u>38,463</u> | <u>41,684</u> |
| | | |
| CHANGE IN FUND NET POSITION | (3,553) | 71 |
| FUND NET POSITION, BEGINNING OF YEAR | <u>106,762</u> | <u>106,691</u> |
| FUND NET POSITION, END OF YEAR | <u>\$ 103,209</u> | <u>\$ 106,762</u> |

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF CASH FLOWS
June 30, 2014 with Comparative Totals for 2013
(expressed in thousands)

| | <u>2014</u> | <u>2013</u> |
|---|------------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Interest received on student loans | \$ 21,174 | \$ 28,874 |
| Interest received on investments | 285 | 299 |
| Bond and note interest paid | (12,943) | (14,524) |
| Bond fees paid | (171) | (215) |
| Loan fees paid | (9,695) | (10,509) |
| Contracted management & servicing fees paid | (13,376) | (13,294) |
| Administrative expenses paid | (32) | (34) |
| Net cash flows from operating activities | <u>(14,758)</u> | <u>(9,403)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES. | | |
| Purchase of educational loans | (9,757) | (5,790) |
| Repayments of educational loans | 140,648 | 167,763 |
| Purchase of investments | - | (600) |
| Proceeds from sale of investments | 600 | 600 |
| Net cash flows from investing activities | <u>131,491</u> | <u>161,973</u> |
| CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES | | |
| Arbitrage rebate paid | - | (2,020) |
| Repayment of bonds | (121,466) | (161,322) |
| Net cash flows from financing activities | <u>(121,466)</u> | <u>(163,342)</u> |
| Net change in cash and equivalents | (4,733) | (10,772) |
| Cash and cash equivalents, beginning of year | <u>37,711</u> | <u>48,483</u> |
| Cash and cash equivalents, end of year | <u>\$ 32,978</u> | <u>\$ 37,711</u> |

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF CASH FLOWS (CONTINUED)
June 30, 2014 with Comparative Totals for 2013
(expressed in thousands)

| | <u>2014</u> | <u>2013</u> |
|---|------------------|------------------|
| A reconciliation of cash and cash equivalents as shown on the balance sheet for MHESAC follows: | | |
| Cash | \$ 2,553 | \$ 5,306 |
| Restricted assets | <u>30,425</u> | <u>32,405</u> |
| Cash and cash equivalents | <u>\$ 32,978</u> | <u>\$ 37,711</u> |

A reconciliation of operating income to net cash flows from operating activities follows:

| | | |
|--|--------------------|-------------------|
| Operating income | \$ (3,553) | \$ 71 |
| Adjustments to reconcile operating income to net cash flows from operations: | | |
| Uncollectible accounts | (29) | 42 |
| Discounted bond accretion | 2,701 | 2,643 |
| Change in assets and liabilities: | | |
| Interest receivable | (12,680) | (13,455) |
| Other assets | (288) | 1,384 |
| Accounts payable and accrued expenses | (871) | (114) |
| Accrued interest payable | <u>(38)</u> | <u>26</u> |
| Net cash flows from operating activities | <u>\$ (14,758)</u> | <u>\$ (9,403)</u> |

Supplemental Information:

| | | |
|--|------------------|------------------|
| Non-cash Investing and Financing Activity: | | |
| Accrued interest capitalized | 13,371 | \$ 16,454 |
| Student loan borrower rebates granted | <u>229</u> | <u>288</u> |
| | <u>\$ 13,600</u> | <u>\$ 16,742</u> |

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

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2014

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, 2011.

Measurement Focus, Basis of Accounting and Basis of Presentation:

As a non-profit entity that has the ability to issue tax-exempt debt, MHESAC is 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). As provided by these standards, MHESAC follows proprietary fund accounting.

In accordance with GAAP, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Statement of Net Position is presented in a classified format and separates unrestricted and restricted assets. The Statement of Revenues, Expenses and Changes in Fund Net Position is formatted to report operating and non-operating revenues and expenses.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and 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 Discussion and Analysis (MD&A) is considered to be required supplemental information and precedes the financial statements.

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. MHESAC maintains deposits at one financial institution. Accounts at this financial institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 for interest-bearing and non-interest bearing accounts. At June 30, 2014, both the book and bank balance amount of MHESAC deposits was \$1,002,198 with \$752,198 exceeding FDIC limits.

The cash and cash equivalents in the restricted fund are comprised of 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 invests in highly liquid investments such as U.S. government obligations. At June 30, 2014, there were no investments in the restricted funds or unrestricted funds. At June 30, 2013 unrestricted fund investment cost approximated 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interest on Educational Loans (Continued):

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 the Federal Family Education Loan Program (FFELP) if the interest rate is below the guaranteed interest rate. Conversely, if the interest rate is above the guaranteed interest rate, the excess portion of the borrower payment is remitted 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. 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. As of June 30, 2014, rebates of \$18,179,785 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 the Federal Family Education Loan Program (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 3 for details on Education Loan Receivable and Uncollectible Loans).

Restricted Assets and Fund Net Position:

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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Restricted Assets and Fund Net Position (Continued):

Loans restricted in the escrow total \$19,114,763 net of an allowance for uncollectible accounts of \$11,945. Cash of \$5,385,802, accrued interest receivable of \$24,197, repayment interest receivable of \$239,084 and other assets of \$128,784 were restricted in the escrow fund as of June 30, 2014. Total restricted assets of \$24,892,630 less associated liabilities of \$150,173 represent the portion of the total restricted fund net position related to the assets held in escrow.

Other restricted 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 fund net position attributable to the revenue bond funds totals \$44,826,914.

NOTE 2. INVESTMENTS

Since the restricted funds are governed by bond indentures, the Corporation adheres to the requirements specified within the bond indenture for investment activity of those funds. 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.

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

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Corporation or bond trustee, and are held by either the counterparty or the counterparty's trust department or agent but not in the Corporation's or bond trustee's name.

The Corporation does not have any custodial credit risk as all securities are held in its name. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit risk.

Investments issued or guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from concentration of credit risk disclosure requirements.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 2. INVESTMENTS (CONTINUED)

Interest rate risk is the risk that interest rate changes will adversely affect the fair value of an investment. The Corporation utilizes the specific identification method in regard to interest rate risk as evidenced by the listing of each specific investment and the related interest rates in the chart below. Investment maturities are structured to meet cash requirements for bond redemption schedules as outlined in the indenture.

The Corporation's investments are reported at fair value when they are classified as trading investments and are reported at amortized cost when they are classified as held-to-maturity investments.

The following summarizes investments held at June 30, 2014:

| <u>INVESTMENTS – CURRENT</u> | <u>AMOUNT</u> | <u>RATE</u> | <u>MATURITY</u> |
|--|----------------------|-------------|-----------------|
| Wells Fargo MT Higher Ed 2012–B Security | <u>\$ 19,500,000</u> | 1.408% | 12/20/2044 |
| | 19,500,000 | | |
| Less interfund holding: | | | |
| Wells Fargo MT Higher Ed 2012–B Security | <u>(19,500,000)</u> | | |
| TOTAL INVESTMENTS | <u>\$ _____</u> | | |

NOTE 3. 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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 3. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES
(CONTINUED)

Educational loans are summarized as follows as of June 30, 2014:

| | |
|-----------------------------------|--------------------------------|
| Student/interim status | \$ 279,050,895 |
| Repayment status | <u>864,507,160</u> |
| Educational loans receivable | 1,143,558,055 |
| Allowance for uncollectible loans | <u>(735,602)</u> |
| Educational loans receivable, net | <u><u>\$ 1,142,822,453</u></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.

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%.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 3. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES
(CONTINUED)

Allowance for Uncollectible Loans (Continued):

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 nonguaranteed portion of the loan portfolio balance. A provision for uncollectible educational loans has been made for the years ended June 30, 2014.

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, 2014, loans in the amount of \$11,085,704 were classified as delinquent more than 270 days, the stage at which a default claim can be filed.

As of June 30, 2014, MHESAC held a loan portfolio of \$1,143,558,055. The average default rate of 2.19% results in a provision for uncollectible educational loans of \$735,602 for the year ended June 30, 2014. Following is a reconciliation of the change in the allowance for uncollectible loans for the year ended June 30, 2014:

| | |
|----------------------------------|-------------------|
| Balance, July 1, 2013 | \$ 716,942 |
| Non-guaranteed write-offs | (10,180) |
| Adjustments per allowance policy | <u>28,840</u> |
| Balance, June 30, 2014 | <u>\$ 735,602</u> |

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, 2014:

| | |
|------------------------|--------------------------------|
| 100% Guarantee | \$ 1,341,531 |
| 98% Guarantee | 653,804,350 |
| 97% Guarantee | 488,159,387 |
| Uninsured | <u>252,787</u> |
| TOTAL PORTFOLIO | <u>\$ 1,143,558,055</u> |

No changes were implemented in the accounting policies or methodologies during the year ended June 30, 2014 regarding calculation of the allowance for uncollectible loans.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 4. RELATED PARTY TRANSACTIONS

MHESAC has entered into agreements with Student Assistance Foundation of Montana (SAF) to provide management and loan servicing to MHESAC, as more fully disclosed in Note 7. SAF has one of its eight 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.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE

Educational Loan Revenue Bonds Payable:

The bonds outstanding are summarized in the table below.

| | |
|--|-------------------------|
| Bonds outstanding at June 30, 2013 | \$ 1,222,284,648 |
| Bond discount amortization during the year | 2,700,688 |
| Bonds redeemed during the year | <u>(121,466,000)</u> |
| Bonds outstanding | 1,103,519,336 |
| Less: internal 2012 bond holding | <u>(19,500,000)</u> |
| Bonds outstanding at June 30, 2014 | <u>\$ 1,084,019,336</u> |

A description of significant terms and conditions of each Student Loan Revenue Bond issue outstanding at June 30, 2014 follows:

| <u>Issue</u> | <u>Year End Interest Rate</u> | <u>Original Issue Amount</u> | <u>June 30, 2014</u> |
|-------------------------------------|-------------------------------|------------------------------|-------------------------|
| Taxable Floating Rate Bonds: | | | |
| 2005 Series B Bonds | 0.351% | \$ 119,140,000 | \$ 68,951,000 |
| 2006 Series A Bonds | 0.331% | 226,775,000 | 81,356,000 |
| 2006 Series C Bonds ** | 1.353% | 30,000,000 | 18,000,000 |
| 2012 Series A-2 Bonds | 1.153% | 649,000,000 | 636,287,000 |
| 2012 Series A-3 Bonds | 1.203% | 305,300,000 | 305,300,000 |
| 2012 Series B-1 ** | 1.353% | <u>19,500,000</u> | <u>19,500,000</u> |
| Total Bonds | | 1,349,715,000 | 1,129,394,000 |
| Less Discount | | <u>(31,625,846)</u> | <u>(25,874,664)</u> |
| TOTAL BONDS | | <u>\$1,318,089,154</u> | <u>\$ 1,103,519,336</u> |

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Educational Loan Revenue Bonds Payable (Continued):

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, 2014

NOTE 5. 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>Outstanding Balance, June 30, 2014</u> |
|-----------------------------|----------------------------|--|----------------------|----------------------------|----------------------------------|---|
| 2005 Senior Series B | 5/26/2005 | 2.27% | 6/20/2030 | Quarterly | 3 month LIBOR + 12 basis points | \$ 68,951,000 |
| 2006 Senior Series A | 5/3/2006 | 2.21% | 3/20/2024 | Quarterly | 3 month LIBOR + 10 basis points | 81,356,000 |
| 2006 Subordinate Series C | 5/3/2006 | 1.40% | 12/20/2044 | monthly | 1 month LIBOR + 120 basis points | 18,000,000 |
| 2012 Senior Series A-2 | 5/4/2012 | 1.20% | 5/20/2030 | monthly | 1 month LIBOR + 100 basis points | 636,287,000 |
| 2012 Senior Series A-3 | 5/4/2012 | 1.25% | 7/20/2043 | monthly | 1 month LIBOR + 105 basis points | 305,300,000 |
| 2012 Subordinate Series B-1 | 5/4/2012 | 1.40% | 12/20/2044 | monthly | 1 month LIBOR + 120 basis points | 19,500,000 |
| | | | | | | <u>\$ 1,129,394,000</u> |

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 5. 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 Date | Expected Principal Reduction Amount |
|---|--|
| September 20, 2014 | \$ 3,416,000 |
| December 20, 2014 | 3,374,000 |
| March 20, 2015 | 3,335,000 |
| June 20, 2015 | <u>3,089,000</u> |
| Total year ended June 30, 2015 | <u>\$ 13,214,000</u> |

Subsequent Years ended June 30,

| | |
|------|---------------|
| 2016 | \$ 11,891,000 |
| 2017 | 11,328,000 |
| 2018 | 10,740,000 |
| 2019 | 10,264,000 |
| 2020 | 9,741,000 |
| 2021 | 1,773,000 |

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2005 – 2006 Bonds (Continued):

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, 2014 | \$ 6,923,000 |
| December 20, 2014 | 6,990,000 |
| March 20, 2015 | 6,928,000 |
| June 20, 2015 | <u>7,043,000</u> |
| Total Year ended June 30, 2015 | <u>\$ 27,884,000</u> |

Subsequent Years ended June 30,

| | |
|------|---------------|
| 2016 | \$ 27,292,000 |
| 2017 | 24,071,000 |
| 2018 | 2,109,000 |

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.

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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2012 Bonds (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 Date | Expected Principal Reduction Amount |
|---|--|
| July 20, 2014 | \$ 11,653,000 |
| August 20, 2014 | 2,226,000 |
| September 20, 2014 | 10,426,000 |
| October 20, 2014 | 8,789,000 |
| December 20, 2014 | 10,603,000 |
| January 20, 2015 | 8,618,000 |
| March 20, 2015 | 10,326,000 |
| April 20, 2015 | 7,531,000 |
| May 20, 2015 | 541,000 |
| June 20, 2015 | <u>10,906,000</u> |
| Total Year ended June 30, 2015 | <u>\$ 81,619,000</u> |

Subsequent Years ended June 30,

| | |
|------|---------------|
| 2016 | \$ 63,235,000 |
| 2017 | 74,746,000 |
| 2018 | 88,487,000 |
| 2019 | 92,176,000 |
| 2020 | 86,496,000 |
| 2021 | 86,462,000 |
| 2022 | 63,066,000 |

The anticipated principal reduction amount for future periods includes \$280,072,292 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, 2014

NOTE 5. 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 | Expected Principal Reduction <u>Amount</u> |
|---|---|
| <u>Years ended June 30,</u> | |
| 2022 | \$ 7,707,000 |
| 2023 | 72,396,000 |
| 2024 | 59,151,000 |
| 2025 | 47,638,000 |
| 2026 | 42,073,000 |
| 2027 | 38,125,000 |
| 2028 | 34,901,000 |
| 2029 | 3,309,000 |

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Retirements:

During the year ended June 30, 2014, 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 | 09/20/2013 | \$ 3,666,000 |
| 2006 Series A | 09/20/2013 | 6,846,000 |
| 2005 Series B | 12/20/2013 | 3,623,000 |
| 2006 Series A | 12/20/2013 | 6,969,000 |
| 2005 Series B | 03/20/2014 | 3,577,000 |
| 2006 Series A | 03/20/2014 | 6,967,000 |
| 2005 Series B | 06/20/2014 | 3,503,000 |
| 2006 Series A | 06/20/2014 | 6,966,000 |
| 2012 Series A1 | 07/20/2013 | 513,000 |
| 2012 Series A1 | 08/20/2013 | 10,698,000 |
| 2012 Series A1 | 09/20/2013 | 6,908,000 |
| 2012 Series A1 | 11/20/2013 | 9,530,000 |
| 2012 Series A1 | 12/20/2013 | 10,295,000 |
| 2012 Series A1 | 01/20/2014 | 297,000 |
| 2012 Series A1 | 02/20/2014 | 11,015,000 |
| 2012 Series A1 | 03/20/2014 | 7,061,000 |
| 2012 Series A1 | 04/20/2014 | 1,557,000 |
| 2012 Series A1 | 05/20/2014 | 8,762,000 |
| 2012 Series A2 | 05/20/2014 | 3,019,000 |
| 2012 Series A2 | 06/20/2014 | 9,694,000 |

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)
 June 30, 2014

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

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> | <u>Interest</u> | <u>Total</u> |
|-------------------------------|---------------------------------|----------------------|-------------------------|
| 2015 | \$ 122,717,000 | \$ 15,326,764 | \$ 138,043,764 |
| 2016 | 102,418,000 | 13,432,774 | 115,850,774 |
| 2017 | 110,145,000 | 11,802,140 | 121,947,140 |
| 2018 | 101,336,000 | 10,117,568 | 111,453,568 |
| 2019 | 102,440,000 | 8,767,087 | 111,207,087 |
| 2020-2024 | 386,792,000 | 26,282,882 | 413,074,882 |
| 2025-2029 | 166,046,000 | 7,652,050 | 173,698,050 |
| 2030-2034 | - | 2,623,200 | 2,623,200 |
| 2035-2039 | - | 2,623,200 | 2,623,200 |
| 2040-2044 | 18,000,000 | 1,721,490 | 19,721,490 |
| 2045-2046 | <u>19,500,000</u> | <u>113,750</u> | <u>19,613,750</u> |
| Total | <u>\$1,129,394,000</u> | <u>\$100,462,905</u> | <u>\$ 1,229,856,905</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, 2014.

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 bonds. 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 in the 2006C subordinate and the 2012 B subordinate at June 30, 2014 is \$44,488 and \$48,195, respectively.

Bond Ratings:

As of June 30, 2014, all outstanding MHESAC Senior bonds are rated AAA by Fitch Ratings and 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, 2014

NOTE 6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Corporation follows the guidance established for measuring fair value under GAAP and related disclosure requirements. As such fair value is considered 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.

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 at June 30, 2014:

| | <u>Carrying Amount</u> | <u>Fair Value</u> |
|------------------------------|-----------------------------------|------------------------------|
| Financial assets: | | |
| Cash and cash equivalents | \$ 32,977,821 | \$ 32,977,821 |
| Interest receivable | 15,320,983 | 15,320,983 |
| Educational loans receivable | <u>1,143,558,055</u> | <u>1,151,639,973</u> |
| Total financial assets | <u>\$ 1,191,856,859</u> | <u>\$ 1,199,938,777</u> |
| Financial liabilities: | | |
| Interest payable | \$ 403,943 | \$ 403,943 |
| Educational bonds payable | <u>1,103,519,336</u> | <u>1,123,220,373</u> |
| Total financial liabilities | <u>\$ 1,103,923,279</u> | <u>\$ 1,123,624,316</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, 2014.

Interest Receivable and Payable:

The carrying amounts of interest receivable and payable are considered to approximate fair value at June 30, 2014, given their short-term nature.

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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 6. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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, 2014 (market approach).

NOTE 7. 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. Management services will be provided to MHESAC for an 18-year term beginning February 1, 2000. 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.

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.

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, 2014, SAF billed MHESAC \$13,373,924. At June 30, 2014, the reconciliation for billed and actual costs resulted in a balance payable to MHESAC of \$187,775. This balance is included in Accounts Receivable balances.

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.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
June 30, 2014

NOTE 8. SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 15, 2014, 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 ASSETS, LIABILITIES AND FUND NET POSITION
 UNDER RESTRICTED BOND INDENTURES

June 30, 2014

(expressed in thousands)

| | 2005 REVENUE BONDS | 2006-1 REVENUE BONDS | 2012 REVENUE BONDS | GRAND TOTAL |
|--|--------------------------|----------------------------|--------------------------|-------------------------|
| ASSETS | | | | |
| Cash and cash equivalents | \$ 3,632 | \$ 7,186 | \$ 14,221 | \$ 25,039 |
| Educational loans receivable, net | 127,764 | 156,685 | 827,896 | 1,112,345 |
| Accrued interest receivable | 827 | 930 | 13,136 | 14,893 |
| Inter-fund Activity | (32,739) | (35,181) | 67,920 | - |
| Prepaid costs, net | 2 | 2 | 21 | 25 |
| Other assets | <u>109</u> | <u>87</u> | <u>1,267</u> | <u>1,463</u> |
| Total assets | <u>\$ 99,595</u> | <u>\$ 129,709</u> | <u>\$ 924,461</u> | <u>\$ 1,153,765</u> |
| LIABILITIES AND FUND NET POSITION | | | | |
| LIABILITIES | | | | |
| Accounts payable and accrued expenses | \$ 114 | \$ 179 | \$ 4,666 | \$ 4,959 |
| Accrued interest payable | 7 | 8 | 445 | 460 |
| Educational loan revenue bonds payable | <u>68,951</u> | <u>99,356</u> | <u>935,212</u> | <u>1,103,519</u> |
| Total liabilities | <u>69,072</u> | <u>99,543</u> | <u>940,323</u> | <u>1,108,938</u> |
| FUND NET POSITION | | | | |
| Restricted fund net position (deficit) | <u>30,523</u> | <u>30,166</u> | <u>(15,862)</u> | <u>44,827</u> |
| Total liabilities and fund net position | <u>\$ 99,595</u> | <u>\$ 129,709</u> | <u>\$ 924,461</u> | <u>\$ 1,153,765</u> |

See Independent Auditor's Report.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
 COMBINING SCHEDULE OF REVENUE, EXPENSE AND CHANGE IN
 FUND NET POSITION UNDER RESTRICTED BOND INDENTURES
 June 30, 2014
 (expressed in thousands)

| | 2005 REVENUE BONDS | 2006-1 REVENUE BONDS | 2012 REVENUE BONDS | GRAND TOTAL |
|---|--------------------------|----------------------------|--------------------------|------------------|
| REVENUE | | | | |
| Interest income on investments and cash equivalents | \$ - | \$ 1 | \$ 2 | \$ 3 |
| Interest on educational loans | <u>4,329</u> | <u>4,858</u> | <u>24,758</u> | <u>33,945</u> |
| | <u>4,329</u> | <u>4,859</u> | <u>24,760</u> | <u>33,948</u> |
| EXPENSE | | | | |
| Bond and note interest | 291 | 349 | 14,925 | 15,565 |
| Bond fees | 14 | 24 | 170 | 208 |
| Loan fees | 1,402 | 1,710 | 6,637 | 9,749 |
| Contracted management fees | 25 | 32 | 169 | 226 |
| Contracted loan servicing fees | <u>745</u> | <u>913</u> | <u>4,909</u> | <u>6,567</u> |
| | <u>2,477</u> | <u>3,028</u> | <u>26,810</u> | <u>32,315</u> |
| Excess (deficiency) of revenue over expense | 1,852 | 1,831 | (2,050) | 1,633 |
| FUND NET POSITION (DEFICIT) | | | | |
| BEGINNING OF YEAR | <u>28,671</u> | <u>28,335</u> | <u>(13,812)</u> | <u>43,194</u> |
| FUND NET POSITION (DEFICIT), END OF YEAR | <u>\$ 30,523</u> | <u>\$ 30,166</u> | <u>\$ (15,862)</u> | <u>\$ 44,827</u> |

See Independent Auditor's Report.