

Combined Financial Statements
and Required Supplementary Information

2019

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

June 30, 2019



Combined Financial Statements
and Required Supplementary Information

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

June 30, 2019

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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the "Authority/Corporation"), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Authority/Corporation's combined financial statements as listed in the accompanying table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of Kentucky Education Savings Plan Trust, which statements reflect total assets of \$216,182,145 as of June 30, 2019, and an increase to fiduciary net position of \$4,296,876 for the year ended June 30, 2019. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Kentucky Education Savings Plan Trust, is solely based on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

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

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

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

Opinions

In our opinion, based on our audit and the report of other auditors, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Authority/Corporation as of June 30, 2019, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (unaudited) on pages 3 through 13 and the required supplemental information on pages 74 through 79 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the combined financial statements in an appropriate operational, economic, or historical context. We and other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated September 26, 2019, on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority/Corporation's internal control over financial reporting and compliance.

STROTSMAN AND COMPANY

Louisville, Kentucky
September 26, 2019

Combined Financial Statements
and Required Supplementary Information

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

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Other Matters

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STROTSMAN AND COMPANY

Louisville, Kentucky
September 26, 2019

Management's Discussion and Analysis (Unaudited)

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

June 30, 2019

Description of the Business

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

The Authority/Corporation maintains the following operations:

Outreach - Outreach operations provide critical informational resources to make higher education accessible to Kentucky's current and future generations.

Student Aid – Student Aid operations provide some or all levels of administration of fourteen student aid programs.

College Savings Programs – College Savings operations administer both the Trust and the Plan for the Commonwealth of Kentucky.

Loan Guarantee - Loan guarantee operations maintain loan guarantees for qualified students and parents of qualified students made by approved lenders, under the Federal Family Education Loan Program ("FFELP").

Advantage Loan Origination and Disbursement – Advantage loan origination and disbursement operations consist of credit underwriting, loan origination, and issuing disbursements directly to schools or applicable lenders for the Advantage Loan Program.

School Services – School service operations provide mission focused services to higher education institutions through a contractual relationship.

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June 30, 2019

Loan Finance - Loan finance operations refinance existing long-term debt, originate and acquire private supplemental student loans and acquire rehabilitated FFELP loans, other FFELP loan portfolios and certain other FFELP loans required to be repurchased by the Higher Education Act.

Loan Servicing - The loan servicing operation performs servicing and default prevention activities on FFELP and supplemental loans held by the Authority/Corporation's loan finance operation and other lenders.

Loan Collection - Loan collection operations perform collection activities associated with both defaulted FFELP and Advantage loans.

Industry Update

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of FFELP loans, effective July 1, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on \$1.46 billion of FFELP loans, continues to own \$1 billion of FFELP loans and other education loans, and continues to service an additional \$2 million of FFELP and other education loans. The Authority/Corporation can no longer originate, guarantee or fund any newly originated FFELP loans; however, the Authority/Corporation does continue to look for opportunities to mitigate the impact of the runoff of the FFELP legacy loan portfolio through the acquisition of FFELP rehabilitation loans and other FFELP portfolios. The expansion of the Advantage Loan Program to include additional jurisdictions for lending eligibility and through strategic partnerships serves as a migration to the risk of reduced revenues through the contraction of the loan portfolio.

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

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

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June 30, 2019

As it relates to currently known facts, decisions or conditions that either are expected to, or could, have a significant effect on financial position or results of operations, there are two items worthy of disclosure. First, the Authority/Corporation has regularly shared its willingness and desire to increase its loan guarantee portfolio as certain FFELP Guaranty Agencies continue to assess and evaluate their long-term response to the 2010 elimination of FFELP. Second, the Corporation will begin the process of potential cessation from the Kentucky Retirement System for its nonhazardous employees by formally requesting an estimate of the cost of opting-out through completion of the appropriate Form 7726 – Request for Estimated Cost of Voluntary Cessation from KERS under Kentucky Revised Statute 61.522(8). See subsequent event Note T for a brief description of a currently contemplated January 2020 increase to the Authority/Corporation's guarantee portfolio through the designation of KHEAA as the guarantor for the State of New Jersey, and for a disclosure concerning potential cessation from the Kentucky Retirement System.

Despite certain rating surveillance challenges associated with the student loan sector since 2015, the Authority/Corporation's loan finance operation has remained very active with recent financings closed in July 2018, April 2019 and August 2019. Some of the Authority/Corporation's bonds have been downgraded since 2015 due primarily to the concern by some rating agencies that certain FFELP Asset-Backed Security tranches will not fully pay down by their scheduled final maturity dates. This concern has been driven by an increase in the number of borrowers opting for extended repayment plans. The most widely available extended repayment plan is the Income-Based Repayment ("IBR") plan that caps borrower payments based on income and family size. The downgrades do not impact the cost of funds of the bonds. In addition, spreads have been reasonable since the large widening of spreads immediately subsequent to the 2015 actions. Despite the stable cost of funds and spreads, the Authority/Corporation may respond strategically and specifically in the future to the challenges these downgrades could be having on its investors.

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

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

June 30, 2019

Overview of Financial Statements

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

The combined government-wide statement of net position and statement of activities include the Governmental Funds and Proprietary Funds. The combined government-wide financial statements can be found on pages 14 and 15 of this report. The combined fund financial statements can be found on pages 16 through 23 of this report.

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

The fiduciary fund statement of net position (deficit) and changes in fiduciary net position (deficit) can be found on pages 24 and 25 of this report.

The Trust publishes separate financial statements and footnotes.

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

The following is a condensed summary of financial information for the years ended June 30, 2019 and 2018, respectively.

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

June 30, 2019

	Governmental Fund		Proprietary Funds	
	2019	2018	2019	2018
Net Position Information				
Capital assets			\$ 6,326,963	\$ 6,967,915
Other assets	\$ 57,784,068	\$ 58,747,325	1,274,064,455	1,157,026,549
Total Assets	<u>57,784,068</u>	<u>58,747,325</u>	<u>1,280,391,418</u>	<u>1,163,994,464</u>
Deferred Outflows of Resources:				
Deferred OPEB expense			3,873,269	4,444,522
Deferred pension expense			14,560,641	23,937,183
Total Assets and Deferred Outflows of Resources	<u>57,784,068</u>	<u>58,747,325</u>	<u>1,298,825,328</u>	<u>1,192,376,169</u>
Long-term liabilities			1,018,879,652	962,742,321
Other liabilities	2,181	2,938	127,446,669	72,737,365
Deferred pension expense			2,880,078	3,304,972
Deferred OPEB expense			2,241,345	501,385
Deferred gain on debt retirements, net			12,813,159	14,613,089
Total Liabilities and Deferred Inflows of Resources	<u>2,181</u>	<u>2,938</u>	<u>1,164,260,903</u>	<u>1,053,899,132</u>
Invested in capital assets, net of expended debt proceeds			5,616,963	5,587,915
Unrestricted			(104,864,975)	(57,590,161)
Restricted, other			136,993,096	101,187,149
Restricted for program benefits	57,781,887	58,744,387		
Restricted for student aid and related activities			96,819,341	89,292,134
Total Net Position	<u>\$ 57,781,887</u>	<u>\$ 58,744,387</u>	<u>\$ 134,564,425</u>	<u>\$ 138,477,037</u>
Activity Information				
Interest and investment income fund	\$ 54,515	\$ 149,833	\$ 6,152,372	\$ 1,049,590
Student aid & advancement fund revenue	247,290,017	257,476,830		
Tobacco settlement revenue		1,100,000		
Unclaimed lottery revenue	8,900,000	9,000,000		
Contributions from Agency Operating Fund	1,887,596	2,140,212		
Federal funds revenue	38,400	37,774		
Servicing Fees from external sources			158,701	238,310
Servicing Fees from Education Finance Funds			5,323,665	5,464,222
Debt recovery commission			20,816,199	21,341,419
Federal fees earned			933,558	1,057,030
Default aversion fee income			22,545	133,016
Interest income on loans			15,936,598	15,413,077
Amortization of deferred gain on debt retirements			1,799,930	1,799,930
Guarantee fee				
Gain on the sale of loans			176,222	981,914
Late payment penalties			878,465	910,811
School Services			817,907	965,029
Other income	679,521	543,664	144,813	190,803
Total Revenue	<u>258,850,049</u>	<u>270,448,313</u>	<u>53,160,975</u>	<u>49,545,151</u>
Kentucky Tuition Grant	33,699,590	29,861,386		
College Access Program Grant	83,330,518	73,573,896		
Early Graduation Scholarship	380,708	358,905		
Mary J Young Scholarship				
Early Childhood Development Scholarship	701,094	905,270		
Kentucky National Guard Tuition Award Program	7,362,601	6,879,596		
Kentucky Educational Excellence Scholarship	118,116,233	115,438,152		
Teacher Scholarship	377,099	162,559		
Teacher Loan Forgiveness		1,400,000		
Osteopathic Medicine Scholarship	583,326	316,075		
KHEAA Work-Study Program		506,192		
Go Higher Grant Program		302,831		
Coal County Scholarship Program for Pharmacy Students	516,251	367,330		
Dual Credit Scholarship	5,485,545	6,126,954		
Work Ready Scholarship	6,842,099	3,018,061		
Kentucky Coal County College Completion Scholarship	2,244,019	3,078,184		
John R. Justice Grant	173,466	169,659		
Loan guarantee operations			4,170,380	5,103,731
Default collections			6,318,084	6,757,526
Loan finance and servicing activities			37,959,685	37,745,300
Outreach			3,833,105	3,940,299
Student aid administration			1,887,596	2,140,212
Contribution to student aid programs				
School services			2,763,796	2,752,124
Other activities			140,941	135,452
Total Expenditures	<u>259,812,549</u>	<u>242,465,050</u>	<u>57,073,587</u>	<u>58,574,644</u>
Change in Net Position	<u>\$ (962,500)</u>	<u>\$ 27,983,263</u>	<u>\$ (3,912,612)</u>	<u>\$ (9,029,493)</u>

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

June 30, 2019

Financial Analysis – Governmental and Proprietary Funds

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

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2019. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets and deferred outflows increased approximately \$107 million (9%), from \$1.19 billion to \$1.30 billion. The increase was attributable primarily to increases in cash and cash equivalents and to loans. Cash and cash equivalents increased approximately \$71 million due largely to unexpended bond proceeds from an April 2019 bond transaction in support of Advantage Loan volume over the next two academic years. Loans increased approximately \$38 million as loan acquisition growth exceeded loan runoff for the first time in a number of years.
- The Authority/Corporation's proprietary fund liabilities and deferred inflows increased \$109 million (10.3%) from \$1.05 billion to \$1.16 billion. The overall increase in liabilities and deferred inflows was attributable to the net of various decreases and increases year over year with two large increases being the most material. Long-term debt associated with bonds payable and direct placements increased approximately \$56 million and lines of credit payable also increased approximately \$56 million. The increase related to the former is the net of increases to bonds payable from the July 2018 and April 2018 bond transactions net of pay downs of bonds payable and direct placements on a monthly, quarterly and semi-annual basis. The Authority/Corporation increased its total line of credit capacity in December 2018 by an additional \$30 million. The direct purchase notes issued in August 2018 (see Note T) resulted in approximately \$108 million of line of credit payoffs. The August transaction was the first FFELP-supported financing since December 2017. Hence, lines of credit continued to increase year over.
- The Authority/Corporation's proprietary fund revenues increased \$3.6 million which is comprised primarily of a \$5.1 million increase to interest and investment income net of various other net decreases. See the condensed financial information schedule for Governmental Fund and Proprietary Funds for the detail of these variances year over year.
- The Authority/Corporation's total proprietary fund expenditures decreased approximately \$1.5 million (2.6%), due to the net of various fluctuations that are all less than \$1 million. See the condensed financial information schedule for Governmental Fund and Proprietary Funds for a detailed side by side comparison of expenditures for each business-type activity.

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

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

- The Authority/Corporation's governmental fund assets remained relatively flat year over year.
- The Authority/Corporation's governmental fund liabilities also did not materially change year over year.
- The Authority/Corporation's governmental fund revenues decreased approximately \$11.6 million (4.3%), resulting primarily from less state General Funds for student aid programs.
- The Authority/Corporation's governmental fund expenditures increased approximately \$17.4 million (7.2%) resulting from increases in several student aid programs including, but not limited to, the following: \$3.8 million for Kentucky Tuition Grant, \$9.8 million for College Access Program Grant, \$2.7 million for Kentucky Educational Excellence Scholarships and \$3.8 million for Work Ready Scholarship. These increases were offset by a \$1.4 million decrease in Teacher Loan Forgiveness and the net of several other smaller variances. See the condensed financial information schedule for Governmental Fund and Proprietary Funds for a detailed side by side comparison of Governmental Fund expenditures.

Combined Statement of Net Position – Governmental Fund and Proprietary Funds

Total governmental net position decreased from \$58.7 million to \$57.8 million. Total proprietary fund net position decreased \$3.9 million comprised of a \$14.5 million increase from default collection operations (compared to a \$14.6 million increase in prior year), \$803,000 increase from loan guarantee operations (compared to \$3.5 million decrease in prior year), \$3.8 million contribution for outreach activities (compared to \$3.9 million contribution in prior year), \$1.9 million contribution for student aid administration (compared to \$2.1 million in prior year), \$11.5 million loss in loan finance and servicing activities (compared to \$12.2 million loss in prior year), and \$1.9 million contribution for school services (compared to \$1.8 million in prior year).

Certain highlights related to the combined statement of net position as of June 30, 2019, are as follows:

- The Authority/Corporation maintained \$1.46 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$1 billion of FFELP loans and education loans.
- The Authority/Corporation maintained \$299 million of defaulted loan principal in its collection portfolio.
- Unrestricted net position is presented as a negative amount reflecting the overall decrease to the Corporation's Operating Fund net position due to GASB 68 and 75.
- Net position, restricted other, increased from \$101.2 million to \$137 million due primarily to the overcollateralization contribution related to two bond issuances during FY 2019.

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

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

June 30, 2019

- Net position restricted for student aid and related activities increased from \$89.3 million to \$96.8 million.

Combined Statement of Revenues, Expenses and Changes in Net Position

The \$3.9 million decrease in proprietary fund net position during fiscal year 2019 was \$5.1 million less than the \$9 million decrease during fiscal year 2018. The overall decrease in proprietary fund net position was attributable to the net of a \$7.6 million increase for the Authority and an \$11.5 million decrease for the Corporation. The Authority's increase of \$7.6 million was approximately \$4.4 million more than the prior year increase due primarily to a \$2.7 million increase operating revenues and a \$1.4 million decrease in operating expenses. A slight decrease to program benefits is the remaining variance. The Corporation's loss was largely due to increased pension and OPEB expense. Another critical highlight related to the combined statement of revenues, expenses and changes in net position for the year ended June 30, 2019 is the \$8.7 million of program benefits provided by the Authority/Corporation. The majority of these program benefits directly benefited the citizens of the Commonwealth of Kentucky.

Management's Discussion and Analysis (Unaudited)

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

June 30, 2019

	Federal Student Loan Reserve Fund		Kentucky's Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Net Position Information						
Other assets	\$ 24,099,779	\$ 25,750,908	\$ 58,466,533	\$ 70,753,666	\$ 216,182,145	\$ 212,194,121
Total Assets	24,099,779	25,750,908	58,466,533	70,753,666	216,182,145	212,194,121
Total Liabilities	173,713	3,911,586	96,203,553	108,131,117	208,980	517,832
Restricted net position (deficit)	23,926,066	21,839,322	(37,737,020)	(37,377,451)	215,973,165	211,676,289
Total Net Position	\$ 23,926,066	\$ 21,839,322	\$ (37,737,020)	\$ (37,377,451)	\$ 215,973,165	\$ 211,676,289
Changes in Fiduciary Net Position Information						
Federal reinsurance	\$ 90,422,714	\$ 84,982,446				
Contribution from Agency Operating Fund						
Fee revenue						
Contributions			\$ 184,355	\$ 163,440		
Subscriptions					\$ 54,578,909	\$ 90,372,807
Investment revenue	259,987	84,208	3,815,872	4,628,321	8,814,334	13,155,854
Other income	1,678,930	2,073,273				
Total Additions	92,361,631	87,139,927	4,000,227	4,791,761	63,393,243	103,528,661
Administrative expenses			422,429	375,227	892,995	910,265
Refunds			2,452,259	2,638,957		
Trustee expense			133,662	56,159		
Tuition benefits expense, net			1,351,446	6,210,012		
Loan claims	90,252,342	84,714,059				
Redemptions					58,203,372	90,266,074
Default aversion	22,545	133,016				
Total Deductions	90,274,887	84,847,075	4,359,796	9,280,355	59,096,367	91,176,339
Change in Net Position	\$ 2,086,744	\$ 2,292,852	\$ (359,569)	\$ (4,488,594)	\$ 4,296,876	\$ 12,352,322

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

June 30, 2019

Financial Analysis – Fiduciary Funds

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's fiduciary fund performance for the fiscal year ended June 30, 2019. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- Loan claims paid increased from \$85 million in fiscal year 2018 to \$90 million in fiscal year 2019 (6% increase).
- The Plan noted an increase in the Net Deficit of approximately \$360,000 in fiscal year 2019, due primarily to the net of several different factors including the following: House Bill 250 legislative changes that passed in the 2019 General Assembly and became effective June 27, 2019, gains due to favorable tuition inflation and investment experience, certain changes in program assumptions and other program experience during FY 2019.

Statement of Fiduciary Net Position (Deficit)

The FSLRF net position increased \$2.1 million over ending net position in the prior year. Assets decreased by approximately \$1.7 million while liabilities decreased \$3.7 million. On December 18, 2015, the Consolidated Appropriations Act, 2016, was signed into law and amended the maximum reinsurance rate within Section 428(c)(1) of the Higher Education Act by striking 95% and inserting 100% (see Notes E and S). Therefore, the Authority/Corporation has not recorded a reserve at June 30, 2019 for losses on federal reinsurance. The reinsurance complement to the FSLRF for collections of defaulted student loans has subsequently resulted in year over year increases to the FSLRF net position.

The Plan's total assets decreased \$12.3 million, from \$70.8 million as of June 30, 2018 to \$58.5 million as of June 30, 2019. Total liabilities decreased \$11.9 million from \$108.1 million to \$96.2 million. Detail related to tuition and investment return assumptions, as applicable, include the following:

- 2019-thereafter – The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. The gross investment yield assumption utilized in the calculation of the tuition benefit payable is based on an investment glide path approach for the Plan. The investments in the Plan will change over time to asset allocations that will reduce equity exposure and try to preserve investment gains. A glide path approach should better match projected payouts as the value of the Plan's assets continues to move closer to its depletion date.
- As of June 30, 2019, the actual tuition increase for the 2019-2020 academic year will be 2.8% for the Value Plan and negative .5% for the Standard Plan and Premium Plan. This is the first time in program history that the Standard Plan and the Premium Plan tuition payout values have decreased. The tuition increase assumption for each year thereafter through 2028, when all current participant standard utilization periods expire, will be 5.75%.

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

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

June 30, 2019

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total net position increased approximately \$4.3 million due primarily to investment revenues of \$8.8 million net of (1) administrative expenses of \$893,000 and (2) redemptions outpacing subscriptions by approximately \$3.6 million.

Statement of Changes in Fiduciary Net Position (Deficit)

The FSLRF net position increased \$2.1 million over ending net position in the prior year. Assets decreased nearly \$1.7 million while liabilities decreased \$3.7 million. As noted above, the reinsurance complement to the FSLRF for collections of defaulted student loans has subsequently resulted in year over year increases to the FSLRF net position.

The Plan noted an increase in the Net Deficit of approximately \$360,000 in fiscal year 2019, due primarily to the net of several different factors including the following: House Bill 250 legislative changes that passed in the 2019 General Assembly and became effective June 27, 2019, gains due to favorable tuition inflation and investment experience, certain changes in program assumptions and other program experience during FY 2019.

Combined Government-Wide Statement of Net Position

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

June 30, 2019

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 6,224,121	\$ 42,360,190	\$ 48,584,311
Accounts receivable and prepaid expenses	42,479,664	1,037,921	43,517,585
Receivable from U.S. Department of Education		448,940	448,940
Accrued interest income		26,099,041	26,099,041
Investments		3,337,147	3,337,147
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		136,585,699	136,585,699
Total Current Assets	49,153,785	209,868,938	259,022,723
Noncurrent:			
Restricted cash and cash equivalents		102,231,467	102,231,467
Investments		90,911,371	90,911,371
Fixed assets, net		6,326,963	6,326,963
Loans, net		864,290,629	864,290,629
Teacher and Osteopathic Medicine scholarship loans, net	4,176,690		4,176,690
Teacher and Osteopathic Medicine scholarship advances	4,453,593		4,453,593
Accrued interest income, net		6,762,050	6,762,050
Total Noncurrent Assets	8,630,283	1,070,522,480	1,079,152,763
Total Assets	57,784,068	1,280,391,418	1,338,175,486
Deferred Outflows of Resources:			
Deferred OPEB expense		3,873,269	3,873,269
Deferred pension expense		14,560,641	14,560,641
Total Assets and Deferred Outflows of Resources	57,784,068	1,298,825,328	1,356,609,396
LIABILITIES			
Current:			
Accounts payable and accrued expenses	2,181	6,668,867	6,671,048
Accrued interest expense		3,465,738	3,465,738
Direct borrowing		116,602,064	116,602,064
Capital lease payable		710,000	710,000
Total Current Liabilities	2,181	127,446,669	127,448,850
Noncurrent:			
Allowance for arbitrage liabilities		414,447	414,447
Net OPEB liability		21,777,086	21,777,086
Net pension liability		125,060,322	125,060,322
Direct placements		199,760,490	199,760,490
Payable to Federal Student Loan Reserve Fund		172,670	172,670
Bonds payable, net		671,694,637	671,694,637
Total Noncurrent Liabilities		1,018,879,652	1,018,879,652
Total Liabilities	2,181	1,146,326,321	1,146,328,502
Deferred Inflows of Resources:			
Deferred pension expense		2,880,078	2,880,078
Deferred OPEB expense		2,241,345	2,241,345
Deferred gain on debt retirements, net		12,813,159	12,813,159
Total Liabilities and Deferred Inflows of Resources	2,181	1,164,260,903	1,164,263,084
NET POSITION			
Invested in capital assets, net of expended debt proceeds		5,616,963	5,616,963
Restricted, other		136,993,096	136,993,096
Restricted for program benefits	57,781,887		57,781,887
Restricted for student aid and related activities		96,819,341	96,819,341
Unrestricted		(104,864,975)	(104,864,975)
Total Net Position	\$ 57,781,887	\$ 134,564,425	\$ 192,346,312

Combined Government-Wide Statement of Activities

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

For the Year Ended June 30, 2019

	Direct Expenses	Indirect Expenses	Program Revenue		Net (Expenses) Revenues and Changes in Net Position		Total
			Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	
Governmental Activities:							
Kentucky Tuition Grant	\$ 33,555,766	\$ 143,824		\$ 40,277,470	\$ 6,577,880		\$ 6,577,880
College Access Program Grant	83,186,694	143,824		83,438,461	107,943		107,943
Early Graduation Scholarship	244,000	136,708		380,708			
Early Childhood Development Scholarship	557,275	143,819		358,362	(342,732)		(342,732)
Kentucky National Guard Tuition Award Program	7,218,782	143,819		7,592,427	229,826		229,826
Kentucky Educational Excellence Scholarship	117,944,057	172,176		118,023,470	(92,763)		(92,763)
Teacher Scholarship	233,275	143,824		(72,008)	(449,107)		(449,107)
Dual Credit Scholarship Program	5,330,712	154,833		5,213,210	(272,335)		(272,335)
Osteopathic Medicine Scholarship	439,768	143,558		370,160	(213,166)		(213,166)
Work Ready Scholarship	6,687,270	154,829		2,703,378	(4,138,721)		(4,138,721)
KHEAA Work-Study Program				2,923	2,923		2,923
Coal County Scholarship Program for Pharmacy Students	381,904	134,347		178,407	(337,844)		(337,844)
Kentucky Coal County College Completion Program	2,107,050	136,969		209,615	(2,034,404)		(2,034,404)
John R. Justice Grant	38,400	135,066		173,466			
Total Governmental Activities	257,924,953	1,887,596		258,850,049	(962,500)		(962,500)
Business-Type Activities:							
Loan guarantee operations	4,170,380		\$ 4,972,958			\$ 802,578	802,578
Default collections	6,318,084		20,816,199			14,498,115	14,498,115
Loan finance and servicing activities	37,959,685		26,412,970			(11,546,715)	(11,546,715)
Outreach	3,833,105					(3,833,105)	(3,833,105)
Student aid administration	1,887,596					(1,887,596)	(1,887,596)
School services	2,763,796		817,907			(1,945,889)	(1,945,889)
Other activities	140,941		140,941				
Total Business-Type Activities	57,073,587		53,160,975			(3,912,612)	(3,912,612)
Total Activities	\$ 314,998,540	\$ 1,887,596	\$ 53,160,975	\$ 258,850,049	(962,500)	(3,912,612)	(4,875,112)
Change in Net Position					(962,500)	(3,912,612)	(4,875,112)
Net Position, July 1, 2018					58,744,387	138,477,037	197,221,424
Net Position, June 30, 2019					\$ 57,781,887	\$ 134,564,425	\$ 192,346,312

Combined Statement of Net Position - Proprietary Funds

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

June 30, 2019

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
ASSETS							
Current:							
Cash and cash equivalents	\$ 2,814,668	\$ 21,029,420	\$ 23,844,088		\$ 18,516,102	\$ 18,516,102	\$ 42,360,190
Investments		3,337,147	3,337,147				3,337,147
Accounts receivable and prepaid expenses	46,510	249,887	296,397		741,524	741,524	1,037,921
Accrued interest income		460,172	460,172	\$ 19,475,406	6,163,463	25,638,869	26,099,041
Receivable from U.S. Department of Education		223,000	223,000	355,695	(129,755)	225,940	448,940
Loans, net				120,069,560	16,516,139	136,585,699	136,585,699
Total Current Assets	2,861,178	25,299,626	28,160,804	139,900,661	41,807,473	181,708,134	209,868,938
Noncurrent:							
Restricted cash and cash equivalents				102,231,467		102,231,467	102,231,467
Investments		82,002,226	82,002,226		8,909,145	8,909,145	90,911,371
Fixed assets, net		6,028,253	6,028,253		298,710	298,710	6,326,963
Loans, net				767,029,186	97,261,443	864,290,629	864,290,629
Accrued interest income, net				5,065,813	1,696,237	6,762,050	6,762,050
Total Noncurrent Assets		88,030,479	88,030,479	874,326,466	108,165,535	982,492,001	1,070,522,480
Total Assets	2,861,178	113,330,105	116,191,283	1,014,227,127	149,973,008	1,164,200,135	1,280,391,418
Deferred Outflows of Resources:							
Deferred OPEB expense		308,542	308,542		3,564,727	3,564,727	3,873,269
Deferred pension expense		1,150,103	1,150,103		13,410,538	13,410,538	14,560,641
Total Deferred Outflows		1,458,645	1,458,645		16,975,265	16,975,265	18,433,910
Total Assets and Deferred Outflows of Resources	2,861,178	114,788,750	117,649,928	1,014,227,127	166,948,273	1,181,175,400	1,298,825,328

Combined Statement of Net Position - Proprietary Funds

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

June 30, 2019

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
LIABILITIES							
Current:							
Accounts payable and accrued expenses	737,241	964,508	1,701,749	596,425	4,370,693	4,967,118	6,668,867
Interfund payable (receivable)	2,123,937	(2,272,024)	(148,087)	(4,351,655)	4,499,742	148,087	3,465,738
Accrued interest expense		6,179	6,179	3,158,336	301,223	3,459,559	116,602,064
Direct borrowing					116,602,064	116,602,064	710,000
Capital lease payable		710,000	710,000				
Total Current Liabilities	2,861,178	(591,337)	2,269,841	(596,894)	125,773,722	125,176,828	127,446,669
Noncurrent:							
Net OPEB liability		1,641,003	1,641,003		20,136,083	20,136,083	21,777,086
Net pension liability		9,422,519	9,422,519		115,637,803	115,637,803	125,060,322
Allowance for arbitrage liabilities				414,447		414,447	414,447
Direct placements				199,760,490		199,760,490	199,760,490
Payable to Federal Student Loan Reserve Fund		172,670	172,670				172,670
Bonds payable, net				671,694,637		671,694,637	671,694,637
Total Noncurrent Liabilities		11,236,192	11,236,192	871,869,574	135,773,886	1,007,643,460	1,018,879,652
Total Liabilities	2,861,178	10,644,855	13,506,033	871,272,680	261,547,608	1,132,820,288	1,146,326,321
Deferred Inflows of Resources:							
Deferred pension expense		1,567,228	1,567,228		1,312,850	1,312,850	2,880,078
Deferred OPEB expense		439,073	439,073		1,802,272	1,802,272	2,241,345
Deferred gain on debt retirements, net				12,813,159		12,813,159	12,813,159
Total Liabilities and Deferred Inflows of Resources	2,861,178	12,651,156	15,512,334	884,085,839	264,662,730	1,148,748,569	1,164,260,903
NET POSITION							
Invested in capital assets, net		5,318,253	5,318,253		298,710	298,710	5,616,963
Restricted, other				130,141,288	6,851,808	136,993,096	136,993,096
Restricted for student aid and related activities		96,819,341	96,819,341				96,819,341
Unrestricted					(104,864,975)	(104,864,975)	(104,864,975)
Total Net Position	\$	\$ 102,137,594	\$ 102,137,594	\$ 130,141,288	\$ (97,714,457)	\$ 32,426,831	\$ 134,564,425

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

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

For the Year Ended June 30, 2019

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating Revenues:							
Interest Revenues:							
Interest on loans				\$ 41,649,132	\$ 5,028,553	\$ 46,677,685	\$ 46,677,685
Interest and investment income	\$ 4,016,855	\$ 4,016,855		1,550,503	585,014	2,135,517	6,152,372
Amortization of deferred gain on debt retirements				1,799,930		1,799,930	1,799,930
Interest expense on bonds				(27,753,228)	(2,987,859)	(30,741,087)	(30,741,087)
Total Net Interest Revenues	4,016,855	4,016,855		17,246,337	2,625,708	19,872,045	23,888,900
Financing Expenses:							
Provision for loan losses				1,076,567	(11,350)	1,065,217	1,065,217
Provision for arbitrage				44,957		44,957	44,957
Long-term debt credit facility and remarketing fees				30,000	26,123	56,123	56,123
Debt issuance costs				2,578,273		2,578,273	2,578,273
Total Financing Expenses				3,729,797	14,773	3,744,570	3,744,570
Interest Revenues Net of Financing Expenses	4,016,855	4,016,855		13,516,540	2,610,935	16,127,475	20,144,330
Other Operating Revenues:							
Servicing fees from external sources					158,701	158,701	158,701
Servicing fees from Education Finance Funds					5,323,665	5,323,665	5,323,665
Debt recovery commission	20,816,199	20,816,199					20,816,199
Federal fees earned	933,558	933,558					933,558
Default aversion fee income	22,545	22,545					22,545
Gain on sale/purchase of loans				114,870	61,352	176,222	176,222
Late payment penalties				824,534	53,931	878,465	878,465
School services	817,907	817,907					817,907
Other income	\$ 140,941	\$ 140,941			3,872	3,872	144,813
Total Operating Revenues	140,941	26,607,064	26,748,005	14,455,944	8,212,456	22,668,400	49,416,405

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

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

For the Year Ended June 30, 2019

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating Expenses:							
Administrative expenses	140,941	9,931,480	10,072,421		27,546,275	27,546,275	37,618,696
Servicing fees for Operating Fund				5,323,665		5,323,665	5,323,665
Depreciation and amortization		374,448	374,448		250,599	250,599	625,047
Other expenses		182,536	182,536	138,854	798,974	937,828	1,120,364
Total Operating Expenses	140,941	10,488,464	10,629,405	5,462,519	28,595,848	34,058,367	44,687,772
Net Operating Income (Loss) Before Program Benefits		16,118,600	16,118,600	8,993,425	(20,383,392)	(11,389,967)	4,728,633
Program Benefits:							
Principal and interest benefits				156,521	227	156,748	156,748
School service		2,763,796	2,763,796				2,763,796
Outreach		3,833,105	3,833,105				3,833,105
Student aid administration		1,887,596	1,887,596				1,887,596
Total Program Benefits		8,484,497	8,484,497	156,521	227	156,748	8,641,245
Operating Income (Loss) Before Transfers		7,634,103	7,634,103	8,836,904	(20,383,619)	(11,546,715)	(3,912,612)
Transfers (to) from Other Funds							
Interfund transfers				26,202,750	(26,202,750)		
Increase (Decrease) in Net Position After Transfers		7,634,103	7,634,103	35,039,654	(46,586,369)	(11,546,715)	(3,912,612)
Net Position, July 1, 2018		94,503,491	94,503,491	95,101,634	(51,128,088)	43,973,546	138,477,037
Net Position, June 30, 2019	\$ -	\$ 102,137,594	\$ 102,137,594	\$ 130,141,288	\$ (97,714,457)	\$ 32,426,831	\$ 134,564,425

Combined Statement of Cash Flows - Proprietary Funds

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

For the Year Ended June 30, 2019

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Cash Flows from Operating Activities:							
Principal received on loans				\$ 141,294,604	\$ 16,246,164	\$ 157,540,768	\$ 157,540,768
Interest received on loans				31,517,552	(2,856,630)	28,660,922	28,660,922
Special allowance paid				(6,681,379)	(542,959)	(7,224,338)	(7,224,338)
Servicing fees received, internal sources	\$ (140,941)	\$ 76,908	\$ (64,033)	(5,323,665)	5,323,665		(64,033)
School services fees received		817,907	817,907				817,907
Servicing fees received, external sources					135,955	135,955	135,955
Debt recovery commission received		20,816,199	20,816,199				20,816,199
Federal fees received		933,558	933,558				933,558
Default aversion fees received		22,545	22,545				22,545
Outreach		(3,834,605)	(3,834,605)				(3,834,605)
School services		(2,770,609)	(2,770,609)				(2,770,609)
Internal activity-payments to other funds	765,642	(765,642)		159,033	(159,033)		
Loans originated, including costs				(3,311,520)	(98,190,043)	(101,501,563)	(101,501,563)
Administrative expenses paid		(1,914,504)	(1,914,504)	(3,198,608)	(16,749,648)	(18,948,456)	(20,862,960)
Credit facility fees paid				(30,000)	(29,243)	(59,243)	(59,243)
Loans purchased, including premiums				(2,922,069)	(72,187,422)	(75,109,491)	(75,109,491)
Student aid administration		(6,114,903)	(6,114,903)				(6,114,903)
Interfund loan sales and purchases				(147,061,522)	147,061,522		
Client loan receipts					846,328	846,328	846,328
Loan receipts remitted to clients					(827,371)	(827,371)	(827,371)
Net Cash Provided By (Used In) Operating Activities	624,701	7,266,854	7,891,555	4,442,426	(20,928,915)	(16,486,489)	(8,594,934)
Cash Paid from Noncapital Financing Activities:							
Proceeds from debt issued				184,466,646	94,920,573	279,387,219	279,387,219
Debt principal payments				(128,126,000)	(38,778,376)	(166,904,376)	(166,904,376)
Interest on debt				(27,050,050)	(2,838,227)	(29,888,277)	(29,888,277)
Debt issuance costs				(2,578,273)		(2,578,273)	(2,578,273)
Interfund transfers				26,202,750	(26,202,750)		
Increase in Federal Student Loan Reserve receivable		3,105,471	3,105,471				3,105,471
Net Cash Provided By Noncapital Financing Activities		3,105,471	3,105,471	52,915,073	27,101,220	80,016,293	83,121,764
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(182,294)	(182,294)		(172,751)	(172,751)	(355,045)
Interest paid on capital lease		(5,758)	(5,758)				(5,758)
Bond principal payments		(670,000)	(670,000)				(670,000)
Net Cash Used In Capital and Related Financing Activities		(858,052)	(858,052)		(172,751)	(172,751)	(1,030,803)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		79,564,169	79,564,169		8,523,351	8,523,351	88,087,520
Purchases of investments		(83,574,963)	(83,574,963)		(8,701,365)	(8,701,365)	(92,276,328)
Investment income		205,902	205,902	1,418,674	368,155	1,786,829	1,992,731
Net Cash Provided By (Used In) Investing Activities		(3,804,892)	(3,804,892)	1,418,674	190,141	1,608,815	(2,196,077)
Net Increase in Cash and Cash Equivalents	624,701	5,709,381	6,334,082	58,776,173	6,189,695	64,965,868	71,299,950
Cash and Cash Equivalents, July 1, 2018	2,189,967	15,320,039	17,510,006	43,455,294	12,326,407	55,781,701	73,291,707
Cash and Cash Equivalents, June 30, 2019	\$ 2,814,668	\$ 21,029,420	\$ 23,844,088	\$ 102,231,467	\$ 18,516,102	\$ 120,747,569	\$ 144,591,657

Combined Statement of Cash Flows - Proprietary Funds

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

For the Year Ended June 30, 2019

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Reconciliation of Operating Income to Net Cash Provided By (Used In) Operating Activities							
Operating income (loss) before transfers		\$ 7,634,103	\$ 7,634,103	\$ 8,836,904	\$ (20,383,619)	\$ (11,546,715)	\$ (3,912,612)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income				(1,418,674)	(573,210)	(1,991,884)	(1,991,884)
Depreciation and amortization		745,398	745,398		250,599	250,599	995,997
Amortization of deferred gain on debt retirements				(1,799,930)		(1,799,930)	(1,799,930)
Amortization, expense and write-off of debt issuance costs				2,578,273		2,578,273	2,578,273
Interest expense		5,758	5,758	27,753,228	2,987,859	30,741,087	30,746,845
Provision for loan losses				1,076,567	(11,350)	1,065,217	1,065,217
Borrower interest converted to principal				(16,175,419)	(4,458,885)	(20,634,304)	(20,634,304)
Loan forgiveness				156,521	203	156,724	156,724
Pension expense		(464,116)	(464,116)		11,431,291	11,431,291	10,967,175
OPEB expense					826,688	826,688	826,688
(Increases) decreases in assets:							
Accounts receivables and prepaid expenses	\$ (17,345)	40,935	23,590		321,931	321,931	345,521
Accrued interest receivable		35,973	35,973	(1,784,969)	(4,199,226)	(5,984,195)	(5,948,222)
Principal received on loans				141,294,604	16,246,164	157,540,768	157,540,768
Loans purchased, including premiums				(2,922,069)	(72,187,422)	(75,109,491)	(75,109,491)
Loans originated, including costs				(3,311,520)	(98,190,043)	(101,501,563)	(101,501,563)
Interfund loan sales and purchases				(147,061,522)	147,061,522		
Increases (decreases) in liabilities:							
Accounts payable and accrued expenses	132,241	276,629	408,870	(2,110)	130,291	128,181	537,051
Payable to U.S. Department of Education				(2,981,448)	(22,675)	(3,004,123)	(3,004,123)
Interfund receivable/payable	509,805	(1,002,068)	(492,263)	159,033	(159,033)		(492,263)
Accrued interest payable		(5,758)	(5,758)				(5,758)
Allowance for arbitrage liabilities				44,957		44,957	44,957
Net Cash Provided By (Used In) Operating Activities	\$ 624,701	\$ 7,266,854	\$ 7,891,555	\$ 4,442,426	\$ (20,928,915)	\$ (16,486,489)	\$ (8,594,934)

Balance Sheet - Governmental Fund

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

June 30, 2019

	Governmental Fund <u>Student Aid</u>
ASSETS	
Current:	
Cash and cash equivalents	\$ 6,224,121
Accounts receivable	42,479,664
Teacher and Osteopathic Medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>49,153,785</u>
Noncurrent:	
Teacher and Osteopathic Medicine scholarship loans, net of allowance of \$3,240,000	4,176,690
Teacher and Osteopathic Medicine scholarship advances	<u>4,453,593</u>
Total Noncurrent Assets	<u>8,630,283</u>
Total Assets	<u>57,784,068</u>
LIABILITIES	
Current:	
Accounts payable	<u>2,181</u>
Total Liabilities	<u>2,181</u>
FUND BALANCE	
Restricted for program benefits	<u><u>\$ 57,781,887</u></u>

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

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

For the Year Ended June 30, 2019

	Governmental Fund
	Student Aid
Revenues:	
Interest and investment income fund	\$ 54,515
Unclaimed lottery revenue	8,900,000
State General Fund revenue	247,290,017
Federal funds revenue	38,400
Other income	679,521
Contribution from Agency Operating Fund	1,887,596
	<hr/>
Total Revenues	258,850,049
	<hr/>
Expenditures:	
Kentucky Tuition Grant	33,699,590
College Access Program Grant	83,330,518
Early Graduation Scholarship	380,708
Early Childhood Development Scholarship	701,094
Kentucky National Guard Tuition Award Program	7,362,601
Kentucky Educational Excellence Scholarship	118,116,233
Teacher Scholarship	377,099
Osteopathic Medicine Scholarship	583,326
Coal County Scholarship Program for Pharmacy Students	516,251
Dual Credit Scholarship Program	5,485,545
Work Ready Scholarship	6,842,099
Kentucky Coal County College Completion Program	2,244,019
John R. Justice Grant	173,466
	<hr/>
Total Expenditures	259,812,549
	<hr/>
Net Change in Fund Balance	(962,500)
	<hr/>
Fund Balance, July 1, 2018	58,744,387
	<hr/>
Fund Balance, June 30, 2019	\$ 57,781,887
	<hr/> <hr/>

Statement of Fiduciary Net Position (Deficit)

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

June 30, 2019

ASSETS	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Current:			
Cash and cash equivalents	\$ 21,853,031	\$ 940,808	\$ 93,801
Contributions receivable		178,007	
Fees receivable		10,027	
Receivable from U.S. Department of Education	2,074,078		
Investments		57,216,918	215,294,723
Other current assets			793,621
Total Current Assets	23,927,109	58,345,760	216,182,145
Noncurrent:			
Receivable from Agency Operating Fund	172,670		
Contributions receivable		120,773	
Total Assets	24,099,779	58,466,533	216,182,145
LIABILITIES			
Current:			
Accounts payable	173,713	29,394	136,729
Accrued expenses			72,251
Tuition benefits payable		15,688,779	
Total Current Liabilities	173,713	15,718,173	208,980
Noncurrent:			
Tuition benefits payable		80,485,380	
Total Liabilities	173,713	96,203,553	208,980
NET POSITION (DEFICIT)			
Restricted for program benefits		(37,737,020)	215,973,165
Restricted for other purposes	23,926,066		
Total Net Position (Deficit)	\$ 23,926,066	\$ (37,737,020)	\$ 215,973,165

Statement of Changes in Fiduciary Net Position (Deficit)

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

For the Year Ended June 30, 2019

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Additions:			
Federal reinsurance	\$ 90,422,714		
Contract income, net		\$ 184,355	
Subscriptions			\$ 54,578,909
Investment Revenues:			
Net unrealized gain (loss) on investments		(1,687,283)	1,479,112
Interest and investment income	259,987	5,503,155	7,335,222
Other income	1,678,930		
Total Additions	92,361,631	4,000,227	63,393,243
Deductions:			
Program benefits:			
Loan claims	90,252,342		
Default aversion fee expense	22,545		
Redemptions			58,203,372
Administrative expenses		41,028	892,995
Personnel and professional expenses		381,401	
Refunds		2,452,259	
Trustee fee expense		133,662	
Tuition benefits expense, net		1,351,446	
Total Deductions	90,274,887	4,359,796	59,096,367
Change in Net Position	2,086,744	(359,569)	4,296,876
Net Position (Deficit), July 1, 2018	21,839,322	(37,377,451)	211,676,289
Net Position (Deficit), June 30, 2019	\$ 23,926,066	\$ (37,737,020)	\$ 215,973,165

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

June 30, 2019

Note A--Description of Business

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

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

Outreach Programs

Outreach - Outreach operations provide critical informational resources to make higher education accessible to Kentucky's current and future generations. Outreach counselors at the Authority/Corporation are available year-round to provide free college planning and financial aid assistance to students and families, school counselors, adult education programs and other community contacts. They conduct scholarship and other funding searches, help students with the admissions and financial aid application processes and increase motivation for at-risk students. Outreach services are offered through classroom presentations, financial aid nights, career fairs, college nights, adult education classes, Free Application for Federal Student Aid ("FAFSA") workshops, financial literacy workshops, professional development/staff training and other programs and camps. Programs and services also include a mobile college-planning classroom, a one-stop Web portal, near-peer college coaches and targeted publications for students of all ages. Other Outreach initiatives include Kentucky College Application Campaign, which provides participating seniors with hands-on assistance in applying to college or technical school; Close the Deal, which connects students with community leaders and business representatives to set and meet goals for college and future careers; College Decision Day, which celebrates and recognizes seniors for making educational plans beyond high school; and the Kentucky College Coaches Program, in which

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

June 30, 2019

Note A--Description of Business--Continued

recent college graduates serve as coaches to students in schools with predominantly first-generation, low-income students.

Student Aid Programs

Student Aid – During FY2019 the Authority/Corporation provided some or all levels of administration of fourteen student aid programs: (1) Kentucky Tuition Grant (“KTG”), (2) College Access Program Grant (“CAP”), (3) Kentucky Educational Excellence Scholarship, (4) Teacher Scholarship, (5) Osteopathic Medicine Scholarship, (6) Kentucky Coal County College Completion Program, (7) Early Childhood Development Scholarship, (8) Coal County Scholarship Program for Pharmacy Students, (9) Work Ready Kentucky Scholarship, (10) John R. Justice Grant, (11) Kentucky National Guard Tuition Award Program, (12) Early Graduation Scholarship, (13) Minority Educator Recruitment and Retention Scholarship, and (14) Dual Credit Scholarship Program.

Kentucky Educational Savings Plan Trust

The Trust was formed on July 15, 1988, by Kentucky law, to help families save for the costs of higher education. The Trust is administered by the Authority/Corporation’s Board of Directors. The Authority had a contract with TIAA-CREF Tuition Financing, Inc. (“TFI”), a wholly-owned subsidiary of Teachers Insurance and Annuity Association of America (“TIAA”) from July 1, 2018 through February 22, 2019. On February 22, 2019, program administration of the Trust converted from TIAA to Ascensus College Savings Recordkeeping Services, LLC. The Trust is operated in a manner such that it is exempt from registration as an investment company under the Investment Company Act of 1940. The Trust offers certain federal and state tax advantages to account owners.

An individual or entity participating in the Trust establishes an account in the name of a Beneficiary. From July 1, 2018 through February 22, 2019, contributions were made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, the Equity Index Option, the Active Equity Option, and the Guaranteed Option. Effective February 25, 2019, investment contributions with Ascensus as Program Manager consist of the following seven options offered by thirteen different investment companies: the Managed Allocation Option, the Active Bond Option, the Equity Index Option, the Active Equity Option, the Capital Preservation Option and the Guaranteed Option. The Guaranteed Option is open only to those in the program as of the February 22, 2019 conversion date.

Contributions in the TIAA Managed Allocation Option were allocated among nine age bands, based on the age of the beneficiary. Each age band invested in varying percentages in the Institutional Class of the International Equity Index, Short-Term Bond, Bond Index, Inflation-Linked Bond, Equity Index, Real Estate Securities, Emerging Market Equity Index, and Guaranteed Funding Agreement of the TIAA-CREF Institutional Mutual Funds. Contributions in the current Ascensus Managed Allocation Option allocate amount seven age bands within an open architecture investment ability. Open architecture helps avoid the conflict of interest that would exist if the administrator only recommended its own products. Each age band invests in varying percentages within the seven investment options and investment choices include the following thirteen new investment companies: American Funds, DFA International, Cohen & Steers, Baird, Prudential, Blackrock, iShares, SPDR, Schwab, Vanguard, PGIM, NexBank High Yield Savings and TIAA-CREF Funding Agreement.

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

June 30, 2019

Note A--Description of Business--Continued

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

The TIAA Equity Options invested in varying percentages in the Institutional Class of the International Equity and Growth & Income Funds of the TIAA-CREF Institutional Mutual Funds. The current Ascensus Equity Options are distributed over eighteen offerings from eight different investment companies specializing in equity management.

The Guaranteed Option is contractually obligated to pay a minimum rate of return of 1%. For fiscal year 2019, the Guaranteed investment rate was 1.80%. The NexBank High Yield Savings offered within the Capital Preservation Option had an Annual Percentage Yield of 2.54% as of June 30, 2019.

The Authority also administers the Plan, which was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statutes ("KRS") 164A.700-709. In February 2019, the Authority began collecting a small administrative fee from Trust participants to support program administration.

Prepaid Tuition Plan

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

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan's investment policy goal is to earn rates of return that closely match or exceed anticipated tuition inflation rates and remain sufficiently liquid to meet the Plan's benefit payments in a timely manner. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the Plan currently maintains an accumulated net deficit of approximately \$37.7 million.

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

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education

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

June 30, 2019

Note A--Description of Business--Continued

institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, computers, and required supplies.

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

The Kentucky General Assembly approved certain changes to the Plan during the 2014 Legislative Session that became effective July 2014. These changes included the following: the addition of a utilization period definition; the establishment of a closure date of the Plan; the establishment of certain limitations on the growth of a plan account beyond the utilization period; the prohibition of projected college entrance year extensions; and the clarification of provisions for transferring a plan account to another qualified tuition program. During the 2019 General Assembly, House Bill 250 was passed and became effective June 27, 2019. With the law change, the KAPT program established a new eight (8) year full growth value beyond the Projected College Entrance Year for all accounts. The law also extends the plan close date to June 30, 2030.

As of June 30, 2019, the Plan maintained a present value fund deficit of \$37.7 million. This represents a \$360,000 increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2030, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$44.7 million.

Loan Guarantee Operations

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

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

June 30, 2019

Note A--Description of Business--Continued

lender specialty claims such as death, disability or bankruptcy and collecting loans on which default claims have been paid. The Authority/Corporation also educates lenders about FFELP requirements and regulatory changes.

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

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

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

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

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

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

June 30, 2019

Note A--Description of Business--Continued

Advantage Loan Origination and Disbursement Operations

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

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

School Services Operations

School service operations provide mission focused services to higher education institutions through a contractual relationship. KHEAA Verify provides services associated with the required verification of the Free Application for Federal Student Aid ("FAFSA") information submitted by potential students at an institution. These services help simplify the cumbersome verification process for families and institutions. Cohort Default Management Services engage current and former students of institutions to educate them about persistence and completing their education and/or successfully repaying any educational debt while providing information about the various options available. These services help reduce defaults that have severe long-term consequences for families and that can impact an institution's participation in both federal and state student aid programs. New areas of services are continuously analyzed and evaluated based on the needs of school partners across the Commonwealth and beyond. A new service recently developed by the Authority/Corporation will provide support in generating notifications of estimated indebtedness to students to encourage responsible student borrowing and to better manage successful repayment of student loans. Personnel, professional and administrative costs associated with school services are accounted for in the Agency Operating Fund ("AOF"), a proprietary fund of the Authority/Corporation and through the collection of revenues generated through service contracts with each institution.

Personnel, professional and administrative costs associated with school services are accounted for in the proprietary fund of the Authority/Corporation and are reported in the "Program Benefits" section of the Combined Statement of Revenues, Expenditures and Changes in Net Position – Proprietary Funds.

Loan Finance, Servicing and Collection Operations

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

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

June 30, 2019

Note A--Description of Business--Continued

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

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

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

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

As of June 30, 2019, the Authority/Corporation held and/or serviced approximately \$1 billion outstanding principal amount of FFELP and other education loans. \$892 million of loans were pledged pursuant to the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 Indenture, the 2017 Indenture, and the 2018 Indenture. The remaining \$133 million of loans were funded by the Corporation's Operating Fund. Also, the Authority/Corporation services approximately \$2 million of FFELP and other education loans on behalf of other holders. The majority of such education loans are serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP and other education loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

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Note B--Summary of Significant Accounting Policies

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

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

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

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

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

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

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

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

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

of program participants. Assets of the Plan are held by the Authority/Corporation to offset future tuition obligations.

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

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

The Plan maintains a separate investment policy. On May 30, 2019, a change to the target asset allocation was approved and later implemented on July 31, 2019. The target asset allocations in effect as of June 30 and July 31, 2019 are as follows:

	<u>Effective June 30, 2019</u>	<u>Effective July 31, 2019</u>
Large Cap U.S. Equities	30%	24%
Mid Cap U.S. Equities	5%	3%
Small Cap U.S. Equities	4%	3%
Non-U.S. Equities	9%	6%
Total Equity	<u>48%</u>	<u>36%</u>
Inflation Indexed Bonds	7%	6%
Domestic Fixed Income	44%	33%
Short Duration U.S. Fixed Income	0%	15%
Cash	1%	10%
Total Fixed Income	<u>52%</u>	<u>64%</u>

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

- i. No more than 5% of the total amount of the equity portion of the investment account in the securities of any one issuer;
- ii. No more than 15% of the total amount of the equity portion of the investment account in any one industry, as defined by Standard & Poor's;

**Kentucky Higher Education Assistance Authority/
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Note B--Summary of Significant Accounting Policies--Continued

- iii. For portfolios invested in major-market countries, no more than 10% of the total amount of the equity portion of the investment account in any one country with the exception of those countries whose weighting in the Europe, Australia, and Far East ("EAFE") index is greater than 15%, where a maximum weight of the current country weight in the EAFE benchmark plus 5% is permitted;
- iv. For portfolios invested in emerging markets, no more than 10% of the equity portion of the investment account shall be invested in one country;
- v. A minimum of five countries shall be represented in each investment account; and
- vi. No more than 10% of the total amount of the fixed income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States of America or AAA-related securities issued by government agencies as to which there is no limit.

Under the Kentucky Revised Statutes, the Authority/Corporation's Board of Directors is charged with selecting the various options in which the participants of the Trust can invest their funds. An individual participating in the Trust establishes an account in the name of a Beneficiary. See Kentucky Educational Savings Plan Trust description in Note A for a better understanding of investment options during fiscal year 2019.

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

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

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

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

Allowance for Uncollectible Loans - As discussed in Note A, most FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the ED. Management of the Authority/Corporation believes that all of its respective guaranty agencies and the ED will be able to

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

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

honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan loss on all loans funded through normal operations was \$6.2 million for loan principal and \$680,000 for accrued interest as of June 30, 2019. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2019, the allowance for third party servicing loan losses for loans that have been purchased was \$1.3 million for loan principal and \$761,000 for accrued interest. In July 2015, the Authority/Corporation purchased an uninsured loan portfolio at a substantial discount. As of June 30, 2019, the allowance for the loans purchased at a discount was \$15.4 million for loan principal and \$5.8 million for accrued interest. In addition, the Authority/Corporation records a provision for loan loss related to Teacher and Osteopathic Medicine advances that have converted to loans. As of June 30, 2019, the allowance for advances converted to loans was \$3.2 million.

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

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

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

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

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

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

Income Taxes - The Authority is a state government agency established by the Kentucky General Assembly and the Corporation is an independent *de jure* municipal corporation and political subdivision of the Commonwealth of Kentucky; therefore, they are not subject to federal or state

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

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

income taxes. The Trust and the Plan are state sponsored IRC Section 529 education savings plans and are also not subject to federal or state income taxes.

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

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

Program Revenues - Program revenues are reported in two categories including (1) charges for services and (2) program-specific operating grants and contributions. Charges for services include revenues received in the form of fees and charges for the Authority/Corporation loan guarantee, default collection, interest income from the corporate loan finance and servicing activities, school services, and other activities.

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

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

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

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

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

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

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

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

Unrestricted Net Position - Unrestricted net position is comprised of net position available to be used in operations or transfers of the Authority/Corporation. As of June 30, 2019, the Authority/Corporation's unrestricted net position is (\$104,864,975).

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

Note C--Cash and Investments

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

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

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

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

Note C--Cash and Investments--Continued

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2019, the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained cash on deposit as follows:

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
FDIC Insured		\$ 503,323	\$ 653,976
Uninsured			
Collateralized by securities held by the pledging financial institution		17,335,540	6,961,614
Money market demand deposits			
Money market securities		124,686,082	15,238,131
Cash deposited with Kentucky State Treasurer	<u>\$ 6,280,232</u>	<u>2,815,689</u>	<u>38,343</u>
	<u>\$ 6,280,232</u>	<u>\$ 145,340,634</u>	<u>\$ 22,892,064</u>

Of the \$145.3 million of cash and cash equivalents maintained in the Proprietary Funds, \$24.1 million was held for guarantee operations and the remaining \$121.2 million was held for loan finance and servicing activities.

Of the \$22.9 million of cash and cash equivalents maintained in the Fiduciary Funds, \$21.9 million was related to the FSLRF and the remaining \$1 million was associated with the Plan and the Trust.

As of June 30, 2019, all Proprietary Fund investments were registered in the Authority/Corporation's name and maintained by an external trustee or investment manager, as applicable. The investment balances as of June 30, 2019 are summarized as follows:

	Fair Value	Weighted Average Maturity (in years)
Corporate bonds	\$ 50,313,832	2.89
U.S. Treasury and government agency securities	28,158,698	2.02
Collateralized mortgage obligations	<u>15,775,988</u>	13.38
	<u>\$ 94,248,518</u>	

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

Note C--Cash and Investments--Continued

As of June 30, 2019, Trust investments of \$215.3 million comprised entirely of mutual funds held by Ascensus.

As of June 30, 2019, Plan investments of \$57.2 million comprised primarily of mutual funds held by State Street Global Advisors.

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

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

Credit Risk - The Authority/Corporation's investment policy limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poor's / Moody's rating (as applicable) for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2019:

<u>Rating</u>	<u>Fair Value</u>
AAA / Aaa	\$ 21,844,703
AA / Aa	2,268,293
A / A	12,615,520
BAA / Baa	<u>13,585,315</u>
	<u>\$ 50,313,831</u>

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. No more than 10% of the total amount of fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States or AAA-rated securities issued by government agencies as to which there is no limit. The Plan may invest in short-term commercial paper of any domestic issuer, maturing within 9 months, with a minimum rating of A-1 by Standard & Poor's or Prime 1 by Moody's. As previously noted, at June 30, 2019, the Plan primarily invested in mutual funds.

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

Note C--Cash and Investments--Continued

Fair Value Measurement

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

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

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

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

Fair Value on a Recurring Basis

The Authority/Corporation has the following recurring fair value measurements as of June 30, 2019:

Money Market Securities of \$124,686,082 are valued using quoted market prices. (Level 1 Inputs).

Corporate bonds, U.S. Treasury and government agency securities, and collateralized mortgage obligations of \$94,248,517 were based on Level 2 inputs.

As of June 30, 2019, 100% of the value of the Trust and Plan investments was based on Level 1 inputs.

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

June 30, 2019

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2018	Additions	Disposals	Ending Balance June 30, 2019
Proprietary fund:				
Furniture and equipment	\$ 14,542,757	\$ 355,045	\$ 1,113,011	\$ 13,784,791
Building	12,075,049			12,075,049
System development	55,955			55,955
Student loan servicing system	541,131			541,131
Debt recovery system	81,047			81,047
Accumulated depreciation and amortization	<u>(20,328,024)</u>	<u>(995,997)</u>	<u>(1,113,011)</u>	<u>(20,211,010)</u>
	<u>\$ 6,967,915</u>	<u>\$ (640,952)</u>	<u>\$</u>	<u>\$ 6,326,963</u>
Fiduciary Fund:				
Furniture and equipment	\$ 67,688	\$	\$	\$ 67,688
Accumulated depreciation	<u>(67,688)</u>			<u>(67,688)</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

Depreciation and amortization expense totaled \$995,997 for the year ended June 30, 2019, of which \$856,076 was allocated to business-type activities, \$131,012 allocated to governmental activities, and \$8,909 allocated to the fiduciary activities.

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

Loan guarantee operations	\$ 268,371
Outreach	185,717
School services	45,312
Default collections	106,077
Loan finance and servicing	<u>250,599</u>
	<u>\$ 856,076</u>

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

Note D--Fixed Assets--Continued

The Authority/Corporation has assets under capital lease agreements, as described in Note I, of \$12,075,049 with related accumulated amortization of \$6,499,776. Amortization of assets under capital lease is included in amortization expense in the accompanying combined financial statements. Amortization expense of assets under capital lease agreements was \$402,502 for the year ended June 30, 2019.

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

Pursuant to FFELP, the loan guarantee operating unit of the Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2019, the outstanding balance of aggregate insured student loans was approximately \$1.46 billion.

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

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. On December 18, 2015, the Consolidated Appropriations Act, 2016, was signed into law and amended the maximum reinsurance rate within Section 428(c)(1) of the Higher Education Act by striking 95% and inserting 100%. Therefore, the Authority/Corporation has not recorded a reserve at June 30, 2019 for losses on federal reinsurance. See Footnote S.

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

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

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

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

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

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

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June 30, 2019

Note F--Loans (Finance and Servicing Operations)

The Authority/Corporation originates private supplemental loans, purchases loans and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of generally ten years with most FFELP consolidation loans and many Advantage refinance loans having longer repayment terms. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 1.9% to 12% for the fiscal year ended June 30, 2019 depending upon the type and date of origination of the individual loan. Actual rates may be lower due to interest rate reductions associated with payments via electronic funds transfer or for other reasons such as borrowers making a specified number of consecutive on-time payments.

Loans consist of the following at June 30, 2019:

Stafford - Subsidized	\$ 232,784,406
Stafford - Unsubsidized	268,259,455
PLUS/SLS	15,644,310
Consolidation	312,383,125
Supplemental	185,073,592
Other	<u>10,889,532</u>
Total gross loans	1,025,034,420
Allowance for loan losses	(22,847,527)
Unamortized discount on purchase of loans	<u>(1,310,565)</u>
Loans, net	1,000,876,328
Less amount shown as current assets	<u>136,585,699</u>
Noncurrent loans, net	<u>\$ 864,290,629</u>

All principal and accrued interest on FFELP student loans is insured against borrower death, disability, bankruptcy or default, as long as the Authority/Corporation performs all required loan servicing due diligence activities. In July 2015, the Authority/Corporation purchased an uninsured loan portfolio at a substantial discount. As of June 30, 2019, the allowance for the loan principal purchased at a discount was \$15.4 million. In addition, \$2,218,695 of student loan principal was no longer insured due to violations of due diligence requirements.

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

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

Note G--Special Allowance

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

Note H--Loan and Other Forgiveness

During fiscal year 2019, the Authority/Corporation forgave approximately \$965,000 in loan principal and accrued interest for teachers funded by ED. Also, during fiscal year 2019, the Authority/Corporation provided additional loan forgiveness of \$156,748.

Note I--Capital Lease Payable

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

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

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

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

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

June 30, 2019

Note I--Capital Lease Payable--Continued

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

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

A summary of the activity for the capital lease for the year ended June 30, 2019 is as follows:

	<u>June 30, 2018</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2019</u>
Capital Lease Payable	<u>\$ 1,380,000</u>	<u>\$</u>	<u>\$ 670,000</u>	<u>\$ 710,000</u>

Debt service requirements for the final fiscal year are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2020	\$ 710,000	\$ 37,275

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note J--Revenue Bonds Payable

The balance of revenue bonds and notes payable at June 30, 2019 and the related activity for the year ended June 30, 2019 is as follows:

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest</u>	<u>Beginning Balance July 1, 2018</u>	<u>Bond Refundings</u>	<u>New Issues</u>	<u>Amortization of Premium / (Discount) June 30, 2019</u>	<u>Ending Balance June 30, 2019</u>
<u>2010 Indenture</u>							
2010 A-1	* May 1, 2020	Quarterly					
2010 A-2	* May 1, 2034	Quarterly	\$ 84,245,000	\$ (8,945,000)			\$ 75,300,000
			<u>84,245,000</u>	<u>(8,945,000)</u>			<u>75,300,000</u>
<u>2013-1 Indenture</u>							
2013-1	June 1, 2026	Monthly	<u>204,985,000</u>	<u>(33,950,000)</u>			<u>171,035,000</u>
<u>2013-2 Indenture</u>							
2013-2	June 1, 2028	Monthly	<u>168,393,779</u>	<u>(27,075,000)</u>		\$ 174,612	<u>141,493,391</u>
<u>2014 Indenture</u>							
2014 A	* June 1, 2031	Fixed	12,684,720	(3,060,000)		(44,481)	9,580,239
2017 A	* June 1, 2034	Fixed	38,345,436	(3,680,000)		(271,287)	34,394,149
2019 A1-B1	* June 1, 2036	Fixed			\$ 38,481,646	(100,788)	38,380,858
2019 A2	June 1, 2034	Fixed			60,985,000		60,985,000
			<u>51,030,156</u>	<u>(6,740,000)</u>	<u>99,466,646</u>	<u>(416,556)</u>	<u>143,340,246</u>
<u>2015-1 Indenture</u>							
2015-1	December 1, 2031	Monthly	<u>74,656,000</u>	<u>(10,640,000)</u>			<u>64,016,000</u>
<u>2018 Indenture</u>							
2018-1A	June 1, 2036	Monthly		(2,330,000)	69,000,000		66,670,000
2018-1B	June 1, 2036	Monthly		(6,160,000)	16,000,000		9,840,000
				<u>(8,490,000)</u>	<u>85,000,000</u>		<u>76,510,000</u>
			<u>\$ 583,309,935</u>	<u>\$ (95,840,000)</u>	<u>\$ 184,466,646</u>	<u>\$ (241,944)</u>	<u>\$ 671,694,637</u>

* This bond series is tax exempt

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note J--Revenue Bonds Payable--Continued

The Authority/Corporation's revenue bonds include fixed and variable rates of interest based on various index rates. Those fixed rates and variable index rates ranged from 2.8% to 5.0% as of June 30, 2019.

Debt service requirements to maturity or redemption date, assuming interest rates based on fixed rates and variable index rates at June 30, 2019, are as follows:

	Principal Repayment Amount (Thousands)						Total
	2010	2013-1	2013-2	2014	2015-1	2018-1	
Year Ending June 30, 2020				\$ 4,665		\$ 3,200	\$ 7,865
Year Ending June 30, 2021				4,990		5,100	10,090
Year Ending June 30, 2022				6,990		6,400	13,390
Year Ending June 30, 2023				7,290		6,900	14,190
Year Ending June 30, 2024				8,640		7,000	15,640
5 Years Ending June 30, 2029		\$ 171,035	\$ 143,094	52,990		17,700	384,819
5 Years Ending June 30, 2034	\$ 75,300			35,830	\$ 64,016	14,210	189,356
5 Years Ending June 30, 2039				17,250		16,000	33,250
	<u>\$ 75,300</u>	<u>\$ 171,035</u>	<u>\$ 143,094</u>	<u>\$ 138,645</u>	<u>\$ 64,016</u>	<u>\$ 76,510</u>	<u>\$ 668,600</u>
	Interest Repayment Amount (Thousands)						
	2010	2013-1	2013-2	2014	2015-1	2018-1	Total
Year Ending June 30, 2020	\$ 2,846	\$ 4,964	\$ 4,296	\$ 5,738	\$ 1,922	\$ 3,132	\$ 22,898
Year Ending June 30, 2021	2,846	4,964	4,296	5,543	1,922	3,025	22,596
Year Ending June 30, 2022	2,846	4,964	4,296	5,341	1,922	2,845	22,214
Year Ending June 30, 2023	2,846	4,964	4,296	5,053	1,922	2,615	21,696
Year Ending June 30, 2024	2,846	4,964	4,296	4,744	1,922	2,361	21,133
5 Years Ending June 30, 2029	14,227	9,929	17,186	17,690	9,610	8,484	77,126
5 Years Ending June 30, 2034	14,227			10,455	3,844	5,890	34,416
5 Years Ending June 30, 2039				1,725		1,687	3,412
	<u>\$ 42,684</u>	<u>\$ 34,749</u>	<u>\$ 38,666</u>	<u>\$ 56,289</u>	<u>\$ 23,064</u>	<u>\$ 30,039</u>	<u>\$ 225,491</u>

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note J--Revenue Bonds Payable--Continued

All assets of the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 Indenture, the 2017 Indenture and the 2018 Indenture are pledged for repayment of the specific bond or note issues under each resolution or program.

Note K--Direct Placements and Direct Borrowings

The Authority/Corporation closed its \$89,500,000 Direct Purchase Series 2016-1 and \$171,068,000 Direct Purchase Series 2017-1 student loan backed notes on June 23, 2016 and December 21, 2017, respectively. On September 12, 2017, the Authority/Corporation executed a new Warehouse Loan and Security Agreement and Amendment to Loan Documents with a commercial bank (the "Bank") to provide up to \$45,000,000 for each of the two Lines of Credit for a total of \$90,000,000. One Line of Credit is a revolving Line of Credit with a three-year term period. On December 19, 2018, the Authority/Corporation and the Bank increased this revolving Line of Credit to \$75,000,000. The \$45,000,000 Line of Credit is a multi-draw term loan ("Credit Facility") with an 18-month period for advances on the Credit Facility followed by a one-year term loan.

The balance of direct purchase notes payable and direct borrowings under lines of credit agreements at June 30, 2019 and the related activity for the year then ended June 30, 2019 is as follows:

	<u>Scheduled Maturity</u>	<u>Interest Rate</u>	<u>Beginning Balance July 1, 2018</u>	<u>Note Maturities & Refundings</u>	<u>New Borrowings</u>	<u>Ending Balance June 30, 2019</u>
<u>Direct Placements</u>						
<u>2016-1 Indenture</u>						
2016-1-1-A & B	* June 1, 2026	Monthly	\$ 38,801,180	\$ (5,380,000)		\$ 33,421,180
2016-1-2-A & B	June 1, 2026	Monthly	27,212,310	(4,311,000)		22,901,310
			<u>66,013,490</u>	<u>(9,691,000)</u>		<u>56,322,490</u>
<u>2017-1 Indenture</u>						
2017-1	* December 1, 2037	Monthly	166,033,000	(22,595,000)		143,438,000
			<u>\$ 232,046,490</u>	<u>\$ (32,286,000)</u>		<u>\$ 199,760,490</u>
<u>Direct Borrowings</u>						
2017 Line of Credit	March 11, 2020	Monthly	\$ 27,180,265		\$ 16,063,574	\$ 43,243,839
2018 Line of Credit	September 11, 2020	Monthly	33,279,602	\$ (38,778,377)	78,857,000	73,358,225
			<u>\$ 60,459,867</u>	<u>\$ (38,778,377)</u>	<u>\$ 94,920,574</u>	<u>\$ 116,602,064</u>

* This bond series is tax exempt

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note K--Direct Placements and Direct Borrowings--Continued

The Authority/Corporation's direct purchase notes include variable rates of interest based on daily one-month LIBOR. Those variable rates ranged from 2.9% to 3.4% as of June 30, 2019.

Debt service requirements to maturity or redemption date, assuming interest rates based on the daily one-month LIBOR at June 30, 2019, are as follows:

Principal Repayment Amount (Thousands)

	<u>2016-1</u>	<u>2017-1</u>	<u>Total</u>
Year Ending June 30, 2020			
Year Ending June 30, 2021			
Year Ending June 30, 2022			
Year Ending June 30, 2023			
Year Ending June 30, 2025			
5 Years Ending June 30, 2029	\$ 56,322		\$ 56,322
5 Years Ending June 30, 2034			
5 Years Ending June 30, 2039		\$ 143,438	143,438
	<u>\$ 56,322</u>	<u>\$ 143,438</u>	<u>\$ 199,760</u>

Interest Repayment Amount (Thousands)

	<u>2016-1</u>	<u>2017-1</u>	<u>Total</u>
Year Ending June 30, 2020	\$ 1,940	\$ 1,922	\$ 3,862
Year Ending June 30, 2021	1,940	1,922	3,862
Year Ending June 30, 2022	1,940	1,922	3,862
Year Ending June 30, 2023	1,940	1,922	3,862
Year Ending June 30, 2024	1,940	1,922	3,862
5 Years Ending June 30, 2029	3,881	9,610	13,491
5 Years Ending June 30, 2034		9,610	9,610
5 Years Ending June 30, 2039		5,766	5,766
	<u>\$ 13,581</u>	<u>\$ 34,596</u>	<u>\$ 48,177</u>

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

June 30, 2019

Note K--Direct Placements and Direct Borrowings--Continued

The collateral for the notes directly placed with an investor is defined in the respective Continuing Covenant Agreements ("CCA") between the Corporation and the Investor as "the Trust Estate other than the moneys and investments held in the Department Rebate Fund and the Treasury Rebate Fund." The student loans backing the direct purchase notes are loans made under the FFEL program. Cash and marketable securities of the Operating Funds of the Authority/Corporation are pledged as collateral against any outstanding balance on the \$75,000,000 Line of Credit. The \$45,000,000 Credit Facility is restricted to the acquisition of loans made through FFELP and is collateralized by the loans financed with funds advanced by the Bank. In addition, both Lines of Credit are also cross-collateralized.

The amount of unused revolving line of credit as of June 30, 2019 was approximately \$1.6 million. Regarding the multi-draw term loan, draws totaling \$45,000,000 have been made on the multi-draw term loan since September 12, 2017. The amount of recycling available under the multi-term loan line of credit is the \$1.5 million difference between the \$43.2 million ending balance and \$41.7 million of June 30, 2019 loan principal and interest for those FFELP loans acquired with the line of credit.

For the two direct placements, the events of default are similar for each and include the following: failure to pay interest for a period of three days; failure to pay principal through either mandatory redemption or on the related note final maturity date; the occurrence of an event of bankruptcy; the receipt by the Trustee and the Corporation of written notice of the existence of an "Event of Default" under the CCA; or, default in the performance or observance of any other of the covenants, agreements or conditions on the part of the Corporation to be kept, observed and performed contained in the Indentures or in the notes, and continuation of such default for a period of 90 days after the earlier of: (1) the actual knowledge thereof by an Authorized Representative of the Corporation; or (2) written notice thereof by a responsible officer of the Trustee to the Corporation. Upon the occurrence and during the continuance of an event of default, the notes shall bear interest at a default rate provided, however, that during the aforementioned 90-day standstill period, as applicable, the notes shall bear interest at a base rate.

For the two direct borrowings under lines of credit agreements, each of the two lines has thirteen possible events of default. Two of these events of default will cause the outstanding balance to be immediately due and payable whereas the other eleven events of default may, at the bank's option cause an acceleration of all amounts due and payable. At the Bank's option, the notes would bear interest at a default rate from the date of occurrence of the event of default.

Note L--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, may be satisfied in three ways (1) yield adjustment payments with respect to (a) non-purpose obligations allocated to bonds issued on a variable rate basis, and (b) purpose obligations that were acquired after July 18, 2016 or that were acquired prior to such date if allocated to tax exempt bonds bearing interest on a variable rate basis or to tax exempt bonds issued primarily to finance Federal Family Education Loan Program loans, (2) loan forgiveness, and (3) arbitrage rebate. At June 30, 2019, the Authority/Corporation is reporting liabilities for excess yield on acquired purpose and non-purpose investments of \$414,447.

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

June 30, 2019

Note L--Allowance for Arbitrage Liabilities--Continued

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

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

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

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

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

Note M--Deferred Gain on Retirement of Debt

In fiscal year 2010, the Authority/Corporation purchased \$1.198 billion of its own auction rate securities and retired the debt. The resulting \$80.2 million of gain was deferred and is being amortized over the life of the new debt. In addition in fiscal year 2014, the Authority/Corporation purchased \$358.65 million of its own auction rate securities and retired the debt. This resulted in an additional \$7.2 million of gain which was deferred and is being amortized over the remaining life of the old debt. The Authority/Corporation recognized a gain of \$1.8 million for the year ended June 30, 2019. As of June 30, 2019, there is \$12.8 million of gain remaining to be amortized.

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

June 30, 2019

Note N--Net Pension Liability

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

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

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

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

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

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

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

The employer and each employee contribute a percentage of the employee's creditable compensation. Creditable compensation consists of all wages includable on the employee's Federal Form W-2, Wage and Tax statement, under the heading "Wages, Tips, and Other Compensation". There are two exceptions of payment of wages not included in creditable compensation: (1) the lump-sum compensatory leave payments to employees in Tier 2 and 3 and (2) vacation payout at termination. The Authority employer total contribution rate for FY19 was 83.43% comprised of 71.03% for pension contributions and 12.40% for insurance contributions. The Authority employer total contribution rate for FY18 was 49.47% comprised of 41.06% for pension contributions and 8.41% for insurance contributions. The Corporation employer total contribution rates for FY19 and FY18 were 49.47% comprised of 41.06% for pension contributions and 8.41% for insurance contributions. The employee's contribution rates are as follows: Tier 1 - 5%, Tier 2 and 3 - 6%.

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

June 30, 2019

Note N--Net Pension Liability--Continued

The contributions for the employer and employee are as follows:

	<u>FY19</u>	<u>FY18</u>
Authority: Employer	\$ 591,576	\$ 477,778
Authority: Employee	<u>42,082</u>	<u>48,223</u>
	<u>\$ 633,658</u>	<u>\$ 526,001</u>
Corporation: Employer	\$ 5,067,063	\$ 5,441,929
Corporation: Employee	<u>647,655</u>	<u>688,923</u>
	<u>\$ 5,714,718</u>	<u>\$ 6,130,852</u>
Total: Employer	\$ 5,658,639	\$ 5,919,707
Total: Employee	<u>689,737</u>	<u>737,146</u>
	<u>\$ 6,348,376</u>	<u>\$ 6,656,853</u>

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

Pension Costs. At June 30, 2019, the Authority/Corporation reported a net pension liability of \$125,060,322 for its proportionate share of the KERS's collective net pension liability. The Authority's portion is \$9,422,519 and the Corporation's is \$115,637,803. The net pension liability was measured as of June 30, 2018, and the total pension liability used to calculate the net pension liability was determined by the actuarial valuation as of that date. The Authority/Corporation's estimated proportionate share of the collective net pension liability was based on a projection of the Authority/Corporation's long-term share of contributions to the pension plan relative to the projected contributions of all employer participants, as actuarially determined. The Authority's contributions during the measurement period as provided by KRS were \$434,346 with a proportionate share percentage of .069264%. The Corporation's contributions during the measurement period as provided by KRS were \$5,330,530 with a proportionate share percentage of .850042%.

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

June 30, 2019

Note N--Net Pension Liability--Continued

There are two primary methods that can be utilized to allocate the estimated unfunded net pension liability. The first method is the aforementioned "by payroll" method. This method determines each employer's share of the total payroll and allocates the unfunded net pension liability using that same share percentage. The second method calculates each employer's portion of the unfunded net pension liability. This second methodology is more of a specific identification methodology. The Authority/Corporation believe that "by payroll" was most likely selected as the methodology to allocate the unfunded net pension liability due to the ease and simplicity of this approach. The specific identification approach is less transparent and not as simple. The Authority/Corporation believe that the specific identification methodology for allocating the unfunded net pension liability would have resulted in a materially less June 30, 2019 net pension liability for the Corporation. The "by payroll" methodology does not reflect each employer's real liability. Management believes that the Corporation's real net pension liability is significantly less than the recorded net pension liability included in the financial statements herein. Management is not in possession of any information related to the Authority's real net pension liability that would indicate whether the Authority's real net pension liability may be materially different than its recorded net pension liability included in the financial statements herein.

For the year ended June 30, 2019, the Authority/Corporation recognized pension expense of \$16,663,660 for its proportionate share of KERS's pension expense. The Authority's portion was \$165,306 and the Corporation's was \$16,498,354.

At June 30, 2019, the Authority reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

<u>Authority</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience	\$ 67,116	\$ 26,355
Net difference between projected and actual investment earnings on pension plan investments	70,621	61,625
Changes in assumptions	420,790	
Changes in proportion and differences between employer contributions and proportionate share of contributions		1,479,248
Authority's contributions to KERS subsequent to the measurement date	591,576	
	<u>\$ 1,150,103</u>	<u>\$ 1,567,228</u>

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note N--Net Pension Liability--Continued

\$591,576 reported as deferred outflows of resources related to pensions resulting from the Authority's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2020. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Authority Deferred Outflows of Resources

<u>Original Deferral Year</u>	<u>Original Deferral Amount</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>
2015	\$ 515,941	\$ (128,985)	\$ (128,985)	\$ (128,985)	\$ (128,986)			
2016	595,650		(148,913)	(148,913)	(148,913)	\$ (148,911)		
2017	886,964			(221,741)	(221,741)	(221,741)	\$ (221,741)	
2018	(533,506)				133,377	133,377	133,377	\$ 133,375
	<u>\$ 1,465,049</u>	<u>\$ (128,985)</u>	<u>\$ (277,898)</u>	<u>\$ (499,639)</u>	<u>\$ (366,263)</u>	<u>\$ (237,275)</u>	<u>\$ (88,364)</u>	<u>\$ 133,375</u>
Amortization 2019								<u>\$ 499,639</u>
Unamortized Amount 2019								<u>\$ 558,527</u>

Authority Deferred Inflows of Resources

<u>Original Deferral Year</u>	<u>Original Deferral Amount</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>
2014	\$ 117,000	\$ (29,250)	\$ (29,250)	\$ (29,250)	\$ (29,250)				
2015	174,511		(43,628)	(43,628)	(43,628)	\$ (43,627)			
2016	200,939			(50,235)	(50,235)	(50,235)	\$ (50,234)		
2017	662,363				(165,591)	(165,591)	(165,591)	\$ (165,590)	
2018	926,360					(231,590)	(231,590)	(231,590)	\$ (231,590)
	<u>\$ 2,081,173</u>	<u>\$ (29,250)</u>	<u>\$ (72,878)</u>	<u>\$ (123,113)</u>	<u>\$ (288,704)</u>	<u>\$ (491,043)</u>	<u>\$ (447,415)</u>	<u>\$ (397,180)</u>	<u>\$ (231,590)</u>
Amortization 2019									<u>\$ 288,704</u>
Unamortized Amount 2019									<u>\$ 1,567,228</u>

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note N--Net Pension Liability--Continued

At June 30, 2019, the Corporation reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

Corporation	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 823,678	\$ 323,441
Net difference between projected and actual investment earnings on pension plan investments	866,692	756,294
Changes in assumptions	5,164,140	
Changes in proportion and differences between employer contributions and proportionate share of contributions	1,488,964	233,115
Corporation's contributions to KERS subsequent to the measurement date	5,067,064	
	\$ 13,410,538	\$ 1,312,850

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note N--Net Pension Liability--Continued

\$5,067,064 reported as deferred outflows of resources related to pensions resulting from the Corporation's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2020. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Corporation Deferred Outflows of Resources

Original Deferral Year	Original Deferral Amount	2017	2018	2019	2020	2021	2022	2023
2015	\$ 7,181,849	\$(1,795,462)	\$(1,795,462)	\$(1,795,462)	\$(1,795,463)			
2016	4,731,726		(1,182,932)	(1,182,932)	(1,182,932)	\$ (1,182,930)		
2017	9,286,085			(2,321,521)	(2,321,521)	(2,321,521)	\$ (2,321,522)	
2018	(2,782,415)				695,604	695,604	695,604	\$ 695,603
	<u>\$18,417,245</u>	<u>\$(1,795,462)</u>	<u>\$(2,978,394)</u>	<u>\$(5,299,915)</u>	<u>\$(4,604,312)</u>	<u>\$(2,808,847)</u>	<u>\$(1,625,918)</u>	<u>\$ 695,603</u>

Amortization 2019 \$ 5,299,915

Unamortized Amount 2019 \$ 8,343,474

Corporation Deferred Inflows of Resources

Original Deferral Year	Original Deferral Amount	2016	2017	2018	2019	2020	2021	2022	2023
2014	\$ 918,000	\$(229,500)	\$(229,500)	\$(229,500)	\$(229,500)				
2015	(688,500)		172,125	172,125	172,125	\$ 172,125			
2016	1,427,639			(356,910)	(356,910)	(356,910)	\$ (356,909)		
2017	1,419,421				(354,855)	(354,855)	(354,855)	\$ (354,856)	
2018	(293,410)					73,353	73,353	73,353	\$ 73,351
	<u>\$ 2,783,150</u>	<u>\$(229,500)</u>	<u>\$(57,375)</u>	<u>\$(414,285)</u>	<u>\$(769,140)</u>	<u>\$(466,287)</u>	<u>\$(638,411)</u>	<u>\$(281,503)</u>	<u>\$ 73,351</u>

Amortization 2019 \$ 769,140

Unamortized Amount 2019 \$ 1,312,850

Actuarial Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2018, using the entry age normal cost method and the following actuarial assumptions:

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

Salary increases were based on a service-related table.

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note N--Net Pension Liability--Continued

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

The actuarial assumptions used in the June 30, 2018 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013. The Kentucky Retirement systems Board of Directors lowered three actuarial assumptions in May 2017. The inflation rate was lowered from 3.25% to 2.3%, the active member payroll growth was lowered from 4% to 0%, and the investment rate of return was lowered from 6.75% to 5.25%.

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

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

June 30, 2019

Note N--Net Pension Liability--Continued

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

<u>Asset Class</u>	<u>Long Term Expected Real Rate of Return</u>	<u>Target Allocation</u>
U.S. Equity		
US Large Cap	4.50%	8.50%
US Mid Cap	4.50%	5.00%
US Small Cap	5.50%	4.00%
Non US Equity		
International Developed	6.50%	12.50%
Emerging Markets	7.25%	5.00%
Global Bonds	3.00%	10.00%
Credit Fixed		
Global IG Credit	3.75%	10.00%
High Yield	5.50%	3.00%
EMD	6.00%	4.00%
Private Equity	6.50%	10.00%
Real Estate	7.00%	5.00%
Absolute Return	5.00%	10.00%
Real Return	5.00%	10.00%
Cash	1.50%	<u>3.00%</u>
		<u><u>100.00%</u></u>

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

Discount Rate. The discount rate used to measure the total pension liability was 5.25%. The projection of cash flows used to determine the discount rate assumed employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 25 year amortization period of the unfunded actuarial accrued liability.

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

June 30, 2019

Note N--Net Pension Liability--Continued

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

	<u>1% Decrease in Discount Rate</u>	<u>Discount Rate</u>	<u>1% Increase in Discount Rate</u>
KRS Discount Rate	4.25%	5.25%	6.25%
Authority's proportionate share of net pension liability	\$ 10,734,519	\$ 9,422,519	\$ 8,329,519
Corporation's proportionate share of net pension liability	\$ 131,737,803	\$ 115,637,803	\$ 102,228,803

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

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

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

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

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

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

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

June 30, 2019

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

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

Contributions. Contribution percentages are established in state statutes by the Kentucky Legislature. The contribution is a percentage of the employee's creditable compensation. The Authority employer total contribution rate for FY19 was 83.43% comprised of 71.03% for pension contributions and 12.40% for insurance contributions. The Authority employer total contribution rate for FY18 was 49.47% comprised of 41.06% for pension contributions and 8.41% for insurance contributions. The Corporation employer total contribution rates for FY19 and FY18 were 49.47% comprised of 41.06% for pension contributions and 8.41% for insurance contributions. Employees participating on or after September 1, 2008 are required to pay an additional 1% of their credible compensation for health insurance benefits. The contributions for the employer and additional 1% are as follows:

	<u>FY19</u>	<u>FY18</u>
Authority: Employer	\$ 121,168	\$ 97,859
Authority: Employee 1%		
	<u>\$ 121,168</u>	<u>\$ 97,859</u>
Corporation: Employer	\$ 1,037,847	\$ 1,114,628
Corporation: Employee 1%	40,805	40,231
	<u>\$ 1,078,652</u>	<u>\$ 1,154,859</u>
Total: Employer	\$ 1,159,015	\$ 1,212,487
Total: Employee	40,805	40,231
	<u>\$ 1,199,820</u>	<u>\$ 1,252,718</u>

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

June 30, 2019

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

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB. At June 30, 2019, the Authority/Corporation reported a liability of \$21,777,086 for its proportionate share of the KERS's collective net OPEB liability. The Authority's portion is \$1,641,003 and the Corporation's is \$20,136,083. The net OPEB liability was measured as of June 30, 2018, and the total OPEB liability used to calculate the net OPEB liability was determined by the actuarial valuation as of that date. The Authority/Corporation's proportionate share of the net OPEB liability was determined using the employers' actual contributions for FY18. The Authority's contributions during the measurement period as provided by KRS were \$88,978 with a proportionate share percentage of .069214%. The Corporation's contributions during the measurement period as provided by KRS were \$1,091,820 with a proportionate share percentage of .849297%.

There are two primary methods that can be utilized to allocate the estimated unfunded net OPEB liability. The first method is the aforementioned "by payroll" method. This method determines each employer's share of the total payroll and allocates the unfunded net OPEB liability using that same share percentage. The second method calculates each employer's portion of the unfunded net OPEB liability. This second methodology is more of a specific identification methodology. The Authority/Corporation believe that "by payroll" was most likely selected as the methodology to allocate the unfunded net OPEB liability due to the ease and simplicity of this approach. The specific identification approach is less transparent and not as simple. The Authority/Corporation believe that the specific identification methodology for allocating the unfunded net OPEB liability would have resulted in a materially less June 30, 2019 net OPEB liability for the Corporation. The "by payroll" methodology does not reflect each employer's real liability. Management believes that the Corporation's real net OPEB liability is significantly less than the recorded net OPEB liability included in the financial statements herein. Management is not in possession of any information related to the Authority's real net OPEB liability that would indicate whether the Authority's real net OPEB liability may be materially different than its recorded net OPEB liability included in the financial statements herein.

For the year ended June 30, 2019, the Authority/Corporation recognized OPEB expense of \$1,947,857 for its proportionate share of KERS's OPEB expense. The Authority's portion was \$83,322 and the Corporation's was \$1,864,535.

The fully-insured premiums KRS pays for KERS Insurance Fund are blended rates based on the combined experience of active and retired members. Because the average cost of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees, there is an implicit employer subsidy for the non-Medicare eligible retirees. The Authority/Corporation is required to include the liability associated with this implicit subsidy in the deferred outflows and calculation of the total OPEB liability. At June 30, 2019, the Authority/Corporation reported as part of the OPEB expense an implicit subsidy of \$197,335. The Authority's portion is \$14,870 and the Corporation's is \$182,465. At June 30, 2018, the Authority/Corporation reported as part of the deferred outflow an implicit subsidy of \$181,433. The Authority's portion is \$16,823 and the Corporation's is \$164,610.

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

June 30, 2019

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

At June 30, 2019, the Authority reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources related to OPEB, and its contributions subsequent to the measurement date, from the following sources:

<u>Authority</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience		\$ 107,150
Net difference between projected and actual investment earnings on pension plan investments		24,036
Changes in assumptions	\$ 172,504	6,202
Changes in proportion and differences between employer contributions and proportionate share of contributions		301,685
Authority's implicit subsidy to KERS subsequent to the measurement date	14,870	
Authority's contributions to KERS subsequent to the measurement date	<u>121,168</u>	
	<u>\$ 308,542</u>	<u>\$ 439,073</u>

\$121,168 reported as deferred outflows of resources related to OPEB resulting from the Authority's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the year ended June 30, 2020. Amounts reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Year Ending June 30:

2020	\$ (56,519)
2021	(56,519)
2022	(97,012)
2023	
2024	
Thereafter	

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

June 30, 2019

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

At June 30, 2019, the Corporation reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources related to OPEB, and its contributions subsequent to the measurement date, from the following sources:

<u>Corporation</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience		\$ 1,314,795
Net difference between projected and actual investment earnings on pension plan investments		294,930
Changes in assumptions	\$ 2,116,724	76,101
Changes in proportion and differences between employer contributions and proportionate share of contributions	227,691	116,446
Corporation's implicit subsidy to KERS subsequent to the measurement date	182,465	
Corporation's contributions to KERS subsequent to the measurement date	<u>1,037,847</u>	
	<u>\$ 3,564,727</u>	<u>\$ 1,802,272</u>

\$1,037,847 reported as deferred outflows of resources related to OPEB resulting from the Corporation's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2020. Other amounts reported as deferred outflows and inflows of resources related to KERS OPEB will be recognized in OPEB expense as follows:

<u>Year Ending June 30:</u>	
2020	\$ 276,590
2021	276,590
2022	(287,628)
2023	
2024	
Thereafter	

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

June 30, 2019

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

Actuarial Assumptions. The total OPEB liability was determined by an actuarial valuation as of June 30, 2018, using the entry age normal cost method and the following actuarial assumptions:

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

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

The actuarial assumptions used in the June 30, 2018, valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013. The Kentucky Retirement systems Board of Directors lowered three actuarial assumptions in May 2017. The inflation rate was lowered from 3.25% to 2.3%, the active member payroll growth was lowered from 4% to 0%, and the investment rate of return was lowered from 7.50% to 6.25%.

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

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

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

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

<u>Asset Class</u>	<u>Long Term Expected Real Rate of Return</u>	<u>Target Allocation</u>
U.S. Equity		
US Large Cap	4.50%	5.00%
US Mid Cap	4.50%	6.00%
US Small Cap	5.50%	6.50%
Non US Equity		
International Developed	6.50%	12.50%
Emerging Markets	7.25%	5.00%
Global Bonds	3.00%	4.00%
Credit Fixed		
Global IG Credit	3.75%	2.00%
High Yield	5.50%	7.00%
EMD	6.00%	5.00%
Illiquid Private	8.50%	10.00%
Private Equity	6.50%	10.00%
Real Estate	9.00%	5.00%
Absolute Return	5.00%	10.00%
Real Return	7.00%	10.00%
Cash	1.50%	2.00%
		<u>100.00%</u>

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

Discount Rate. The discount rate used to measure the total OPEB liability was 5.86%. This rate is based on the expected rate of return on OPEB plan investments of 6.25% and a municipal bond rate of 3.62%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2018. The projection of cash flows used to determine the discount rate assumed employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 25 year amortization period of the unfunded actuarial accrued liability.

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Kentucky Higher Education Student Loan Corporation**

June 30, 2019

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

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

	<u>1% Decrease</u>	<u>Discount Rate</u>	<u>1% Increase</u>
KRS Discount Rate	4.86%	5.86%	6.86%
Authority's proportionate share of net OPEB liability	\$ 1,925,003	\$ 1,641,003	\$ 1,404,003
Corporation's proportionate share of net OPEB liability	\$ 23,625,083	\$ 20,136,083	\$ 17,232,083

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

	<u>1% Decrease</u>	<u>Healthcare Cost Trend Rate</u>	<u>1% Increase</u>
KRS Healthcare Cost Trend Rate	2.62%	3.62%	4.62%
Authority's proportionate share of net OPEB liability	\$ 1,395,003	\$ 1,641,003	\$ 1,937,003
Corporation's proportionate share of net OPEB liability	\$ 17,120,083	\$ 20,136,083	\$ 23,763,083

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

Payable to the OPEB Plan. At June 30, 2019, the Authority/Corporation reported a payable of \$84,026 for the outstanding amount of contributions to the Insurance Plan required for the year ended June 30, 2019. The Authority's portion is \$10,534 and the Corporation's is \$73,492.

**Kentucky Higher Education Assistance Authority/
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Note P--Tuition Benefits Payable

The following assumptions provided by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2019. These assumptions are based on national and state specific economic data, contractual provisions, previous program actuarial valuation reports, historical state general fund appropriations to the University of Kentucky and KCTCS and actual tuition increases from previous years (2002-2018).

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

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

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

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

Notes to Combined Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
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June 30, 2019

Note P--Tuition Benefits Payable--Continued

- The tuition increases for the 2010-2011 academic year were 4.0% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2011-2012 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2012-2013 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2013-2014 academic year were 2.9% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2014-2015 academic year were 2.1% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2015-2016 academic year were 2.0% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2016-2017 academic year were 4.0% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2017-2018 academic year were 9.0% for the Value Plan and 4.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2018-2019 academic year were 4.1% for the Value Plan and 2.5% for the Standard Plan and the Premium Plan.
- As of June 30, 2019, the actual tuition increase for the 2019-2020 academic year will be 2.8% for the Value Plan and negative .5% for the Standard Plan and Premium Plan. This is the first time in program history that the Standard Plan and the Premium Plan tuition payout values have decreased. The tuition increase assumption for each year thereafter through 2028, when all current participant standard utilization periods expire, will be 5.75%.

For the period from inception to June 30, 2019, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of Kentucky's Affordable Prepaid Tuition Standard and Premium Plans, which represents 95.4% of the Plan's enrollments, has been 7.0%. For the Kentucky Community and Technical College System ("KCTCS"), as applicable to the tuition benefits payout rate of the Value Plan, the average annualized tuition increase from inception to June 30, 2019, has been 8.3%.

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

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June 30, 2019

Note Q--Restricted Net Position

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

- a. **Federal Student Loan Reserve Fund:** Net position is restricted for certain FFELP activities, primarily the payments of claims.
- b. **Agency Operating Fund:** Net position is restricted for certain FFELP activities and other student aid activities.
- c. **Education Finance Funds:** Net position is restricted as required by the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, the 2016 Indenture, the 2017 Indenture and the 2018 indenture.
- d. **Corporation Operating Fund:** Net position is primarily restricted for an estimated amount of mandatory repurchases of loans subject to bankruptcy claims.
- e. **Student Aid Funds:** The Student Aid fund balance is restricted for the Student Aid Programs.
- f. **The Trust:** Net position is restricted for use by trust participants.

Note R--Operating Leases

The Authority/Corporation leases office space and equipment under agreements through 2023. Rental and space utilization expense was \$1,412,817 for the year ended June 30, 2019. Minimum future rental payments for real estate and equipment, including common area maintenance commitments, at June 30, 2019 are as follows:

Year Ending June 30:

2020	\$ 1,325,974
2021	691,483
2022	632,791
2023	21,030
	<hr/>
	<u>\$ 2,671,278</u>

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

June 30, 2019

Note S--Commitments and Contingencies

The FSLRF is contingently liable for loans made by financial institutions that qualify for guarantee. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the fiscal year ended June 30, 2019. Prior to December 1, 2015, the federal government's reinsurance rate for defaults was 100% for loans made prior to October 1, 1993, 98% for loans made on or after October 1993 to September 30, 1998, and 95% for loans made after September 30, 1998. Effective December 1, 2015, the maximum reinsurance rate was amended from 95% to 100%. In the event of future adverse default experience, the FSLRF could be liable for 25% of defaulted loans for a default ratio in excess of 9%. The liability for a default ratio over 5% and up to 9% is 15%. At the beginning of each federal fiscal year, the reinsurance rate returns to applicable baseline; management does not expect that all guaranteed loans could default in one year.

While management believes the FSLRF's expected maximum contingent liability is less than 25% of outstanding guaranteed loans, the maximum contingent liability at June 30, 2019 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 1,463,343,799
Less minimum federal government share - 75%	<u>1,097,507,849</u>
	<u>\$ 365,835,950</u>

Note T--Subsequent Events

On July 24, 2019, a Kentucky pension relief bill, House Bill ("HB") 1, was signed into law by the Governor of the Commonwealth of Kentucky. HB 1 provides an additional one-year freeze of the KERS contribution rate for all Commonwealth quasi-governmental organizations like KHESLC. KERS non-hazardous Non Personnel Cabinet employers like KHESLC were provided a one-year freeze at the 49.47% rate for FY19. HB 1 extends that freeze through June 30, 2020. KERS non-hazardous Personnel Cabinet employers like KHEAA began contributing 83.43% to KRS effective July 1, 2018. In addition to the extension of the KERS contribution rate freeze for an additional year, HB 1 allows quasi-governmental agencies like KHESLC to leave the KERS non-hazardous plan. Any agency that elects to leave must offer their public employees a defined contribution plan. Employers must choose whether they will exit the plan during a window that starts April 1, 2020, and ends April 30, 2020. The effective cessation date for employers is June 30, 2020, at which point agencies leaving the plan could choose a "hard freeze" of employee benefits, meaning no future employees hired after the date will earn benefits in KERS, while employees hired before the date become inactive members in KERS as of the end of June 2020. Employers could also elect to do a "soft freeze," which would mean no future employees hired after June 30, 2020 will earn benefits in KERS; employees hired since January 1, 2014 will become inactive members of the pension plan as of June 30, 2020. Under the "soft freeze," those hired before calendar year 2014 will continue to be active members and earn KERS benefits while employed with the agency after the cessation date. KHESLC must make a request for a preliminary cost estimate to exit the plan by December 31, 2019. January 31, 2020 is the earliest date KRS is required to provide a preliminary cost estimate for employers that requested such estimate 60 days or more prior.

Notes to Combined Financial Statements--Continued

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

June 30, 2019

Note T--Subsequent Events--Continued

On August 1, 2019, the Authority/Corporation received a letter from Federal Student Aid ("FSA"), an Office of the U.S. Department of Education, that such correspondence served as written notice that the Department of Education ("Department") has designated KHEAA as the guarantor for the State of New Jersey effective January 1, 2020. The Department will work closely with representatives from KHEAA and the New Jersey Higher Education Student Assistance Authority ("NJHESAA") with regard to the transition.

On August 15, 2019, the Authority/Corporation issued \$104,965,000 of unrated bonds as "Direct Purchase Notes" with a single investor in support of its FFELP loan acquisition program. The notes are comprised of \$59,560,000 of Class A tax-exempt notes and \$45,405,000 of Class A taxable notes.

Note U--Recent Pronouncements

Statement No. 83, *Certain Asset Retirement Obligations*, addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this statement. This statement was adopted during the current year and did not have an impact on the financial statements.

Statement No. 88, *Certain Disclosures Related to Debt*, including Direct Borrowings and Direct Placements, is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The Statement was adopted during the current year. See the Combined Statement of Net Position – Proprietary Funds and Footnotes J and K for reporting and disclosure changes associated with the adoption of the Statement.

The GASB has issued five additional standards that will become effective for fiscal 2020 and later years' financial statements. The Authority/Corporation is currently evaluating the impact that will result from adopting these GASB standards and is therefore unable to disclose the impact that adopting these standards will have on the Authority/Corporation's financial position and the results of its operations when the standards are adopted.

**REQUIRED SUPPLEMENTARY
INFORMATION**

Schedule of Proportionate Share of the Net Pension Liability and Related Ratios
June 30, 2018

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

	<u>FY 2018</u>	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Authority's proportion of the net pension liability	0.069264%	0.085192%	0.093544%	0.097187%	0.101355%
Authority's proportionate share of the net pension liability	\$ 9,422,519	\$ 11,405,792	\$ 10,663,495	\$ 9,749,658	\$ 9,093,000
Authority's covered-employee payroll	\$ 1,057,832	\$ 1,317,197	\$ 1,556,281	\$ 1,628,998	\$ 1,740,891
Authority's proportionate share of the net pension liability as a percentage of its covered-employee payroll	890.74%	865.91%	685.19%	598.51%	522.32%
Plan fiduciary net position as a percentage of the total pension liability	12.84%	13.30%	14.87%	18.83%	22.32%
	<u>FY 2018</u>	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Corporation's proportion of the net pension liability	0.850042%	0.833570%	0.819117%	0.839524%	0.796208%
Corporation's proportionate share of the net pension liability	\$ 115,637,803	\$ 111,601,157	\$ 93,375,171	\$ 84,220,102	\$ 71,434,000
Corporation's covered-employee payroll	\$ 12,982,294	\$ 12,888,303	\$ 13,627,623	\$ 14,071,702	\$ 13,672,643
Corporation's proportionate share of the net pension liability as a percentage of its covered-employee payroll	890.73%	865.91%	685.19%	598.51%	522.46%
Plan fiduciary net position as a percentage of the total pension liability	12.84%	13.30%	14.87%	18.83%	22.32%
Total collective net pension liability for the Kentucky Employees Retirement System (KERS) non-hazardous employees	\$ 13,603,775,000	\$ 13,388,336,000	\$ 11,399,489,047	\$ 10,031,891,000	\$ 8,971,820,000
KERS' non-hazardous employees total fiduciary net position	\$ 2,004,446,000	\$ 2,056,870,000	\$ 1,980,292,118	\$ 2,327,782,000	\$ 2,578,290,000
KERS' non-hazardous employees total pension liability	\$ 15,608,221,000	\$ 15,445,206,000	\$ 13,379,781,165	\$ 12,359,673,000	\$ 11,550,110,000

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

Schedule of Required Contributions-Pension
June 30, 2018

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

	<u>FY 2018</u>	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Authority's contractually required contribution	\$ 434,346	\$ 552,959	\$ 479,957	\$ 502,383	\$ 567,008
Authority's contributions in relation to the contractually required contribution	(434,346)	(530,040)	(479,957)	(502,383)	(301,000)
Authority's contribution deficiency	<u>\$ -</u>	<u>\$ 22,919</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 266,008</u>
Authority's covered-employee payroll	\$ 1,057,832	\$ 1,317,197	\$ 1,556,281	\$ 1,628,998	\$ 1,740,891
Authority's contributions as a percentage of covered-employee payroll	41.06%	40.24%	30.84%	30.84%	17.29%
	<u>FY 2018</u>	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Corporation's contractually required contribution	\$ 5,330,530	\$ 5,410,509	\$ 4,202,759	\$ 4,339,713	\$ 4,453,180
Corporation's contributions in relation to the contractually required contribution	(5,330,530)	(5,186,253)	(4,202,759)	(4,339,713)	(2,364,000)
Corporation's contribution deficiency	<u>\$ -</u>	<u>\$ 224,256</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,089,180</u>
Corporation's covered-employee payroll	\$ 12,982,294	\$ 12,888,303	\$ 13,627,623	\$ 14,071,702	\$ 13,672,643
Corporation's contributions as a percentage of covered-employee payroll	41.06%	40.24%	30.84%	30.84%	17.29%

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

Note to the Required Supplemental Information-Pension
June 30, 2018

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

Actuarial valuation date	June 30, 2016
Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	25 years
Asset valuation method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Inflation	2.30%
Projected salary increases	0.00%
Investment rate of return	5.25%, net of investment expense, including inflation

Schedule of Proportionate Share of the Net OPEB Liability and Related Ratios
June 30, 2018

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

	<u>FY 2018</u>	<u>FY 2017</u>
Authority's proportion of the net OPEB liability	0.069214%	0.085192%
Authority's proportionate share of the net OPEB liability	\$ 1,641,003	\$ 2,160,437
Authority's covered-employee payroll	\$ 1,057,832	\$ 1,317,197
Authority's proportionate share of the net OPEB liability as a percentage of its covered-employee payroll	155.13%	164.02%
Plan fiduciary net position as a percentage of the total OPEB liability	27.32%	24.40%
	<u>FY 2018</u>	<u>FY 2017</u>
Corporation's proportion of the net OPEB liability	0.849297%	0.833570%
Corporation's proportionate share of the net OPEB liability	\$ 20,136,083	\$ 21,139,020
Corporation's covered-employee payroll	\$ 12,982,294	\$ 12,888,303
Corporation's proportionate share of the net OPEB liability as a percentage of its covered-employee payroll	155.10%	164.02%
Plan fiduciary net position as a percentage of the total OPEB liability	27.32%	24.40%
Total collective net OPEB liability for the Kentucky Employees Retirement System (KERS) non-hazardous employees	\$ 2,370,912,000	\$ 2,535,962,000
KERS' non-hazardous employees total fiduciary net position	\$ 891,205,000	\$ 817,370,000
KERS' non-hazardous employees total OPEB liability	\$ 3,262,117,000	\$ 3,353,332,000

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

Schedule of Required Contributions-OPEB
June 30, 2018

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

	<u>FY 2018</u>	<u>FY 2017</u>
Authority's contractually required contribution	\$ 88,978	\$ 110,776
Authority's contributions in relation to the contractually required contribution	(88,978)	(109,986)
Authority's contribution deficiency	<u>\$ -</u>	<u>\$ 790</u>
Authority's covered-employee payroll	\$ 1,057,832	\$ 1,317,197
Authority's contributions as a percentage of covered-employee payroll	8.41%	8.35%
	<u>FY 2018</u>	<u>FY 2017</u>
Corporation's contractually required contribution	\$ 1,091,820	\$ 1,083,906
Corporation's contributions in relation to the contractually required contribution	(1,091,820)	(1,076,173)
Corporation's contribution deficiency	<u>\$ -</u>	<u>\$ 7,733</u>
Corporation's covered-employee payroll	\$ 12,982,294	\$ 12,888,303
Corporation's contributions as a percentage of covered-employee payroll	8.41%	8.35%

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

Note to the Required Supplemental Information-OPEB
June 30, 2018

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

Actuarial valuation date	June 30, 2016
Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	25 years
Asset valuation method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Inflation	2.30%
Projected salary increases	0.00%
Investment rate of return	6.25%, net of investment expense, including inflation
Healthcare Trend Rates Pre-65	Initial trend starting at 7.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 5 years
Healthcare Trend Rates Post-65	Initial trend starting at 5.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 2 years