KPMG

THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

(A Component Unit of the State of New York)

Financial Statements

March 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

(A Component Unit of the State of New York)

Financial Statements

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

Board of Trustees
New York State Higher Education
Services Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of the New York State Higher Education Services Corporation (HESC), as of and for the years ended March 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise HESC's basic financial statements for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; 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 financial statements based on our audits. We conducted our audits 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 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 auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial positions of the Guaranteed Student Loan Programs' Operating Fund and Federal Fund of the New York State Higher Education Services Corporation, as of March 31, 2017 and 2016, and the respective changes in net position, and cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Other Matters – Required Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 22, 2017 on our consideration of HESC'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 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 HESC's internal control over financial reporting and compliance.

KPMG LLP

Albany, New York
September 22, 2017

Management's Discussion and Analysis

This section of the New York State Higher Education Services Corporation (HESC) Guaranteed Student Loan Programs' financial statements presents management's discussion and analysis of its operations and financial performance during the fiscal years ended March 31, 2017 and 2016. This analysis provides supplementary information on the operations and activities of HESC, and should be read in conjunction with the Operating and Federal Funds' financial statements, which follow this section.

Organization and Operations

HESC is an agency of New York State (NYS) created in 1974 under Chapter 942 of the Laws of 1974 and is responsible for the administration of New York State's student financial aid programs, including the Federal Family Education Loan Program (FFELP) and State loan guarantee program. FFELP was established by Congress and is administered by the U.S. Department of Education (ED) through HESC and other guaranty agencies. As a result of the March 30, 2010 enactment of the Health Care and Education Reconciliation Act (HCERA) (HR4872), new loan guarantees under the FFELP were eliminated effective July 1, 2010.

Under the FFELP, HESC was responsible for processing loans submitted for guarantee and issuing loan guarantees. HESC will continue providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, and collection activities on loans after purchase by HESC. In addition to FFELP, the Guaranteed Student Loan Programs (GSL) include the residual activity of the State guaranteed loan program under which no new loans have been guaranteed since 1984.

HESC has a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund to account for FFELP activity. The Federal Fund assets, and earnings on those assets, are restricted in use and are considered property of ED. The Operating Fund is considered property of HESC, and its assets and earnings may be used generally for guaranty agency and other student financial aid related activities.

2017 Financial Highlights – Operating Fund

- Current assets increased by $4.1 million or 6%.
- Current liabilities decreased by $1.6 million or 11%.
- Total operating revenue decreased by $0.15 million or 0.2%.
- Operating expenses increased by $2.8 million or 5%.
- The Operating Fund provided approximately $16.4 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided approximately $0.6 million for the cost of administering the federal Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) and the College Access Challenge Grant (CACG) for New York State.

- The Operating Fund provided approximately $0.8 million for the cost of administering the Mentor Program, the College Choice Program and NY HELPs Program for New York State.

2017 Financial Highlights – Federal Fund

- Current assets increased by $14.6 million or 28%.
- Total operating revenue decreased by $14.5 million or 2%, as a result of a decline in default claims submitted for reimbursement.
- Total operating expenses decreased by $23.9 million or 4%, as a result of a decline in default claims paid lenders.

2016 Financial Highlights – Operating Fund

- Current assets decreased by $3.6 million or 5%.
- Current liabilities decreased by $0.5 million or 3%.
- Total operating revenue decreased by $2.6 million or 3%.
- Operating expenses decreased by $2.3 million or 4%.
- The Operating Fund provided approximately $10.9 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided approximately $0.8 million for the cost of administering the federal Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) and the College Access Challenge Grant (CACG) for New York State.

2016 Financial Highlights – Federal Fund

- Current assets increased by $5.2 million or 11%.
- Current liabilities increased by $0.6 million or 14,500%.
- Total operating revenue decreased by $26.7 million or 4%, as a result of a decline in default claims submitted for reimbursement.
- Total operating expenses decreased by $34.9 million or 5%, as a result of a decline in default claims paid lenders.

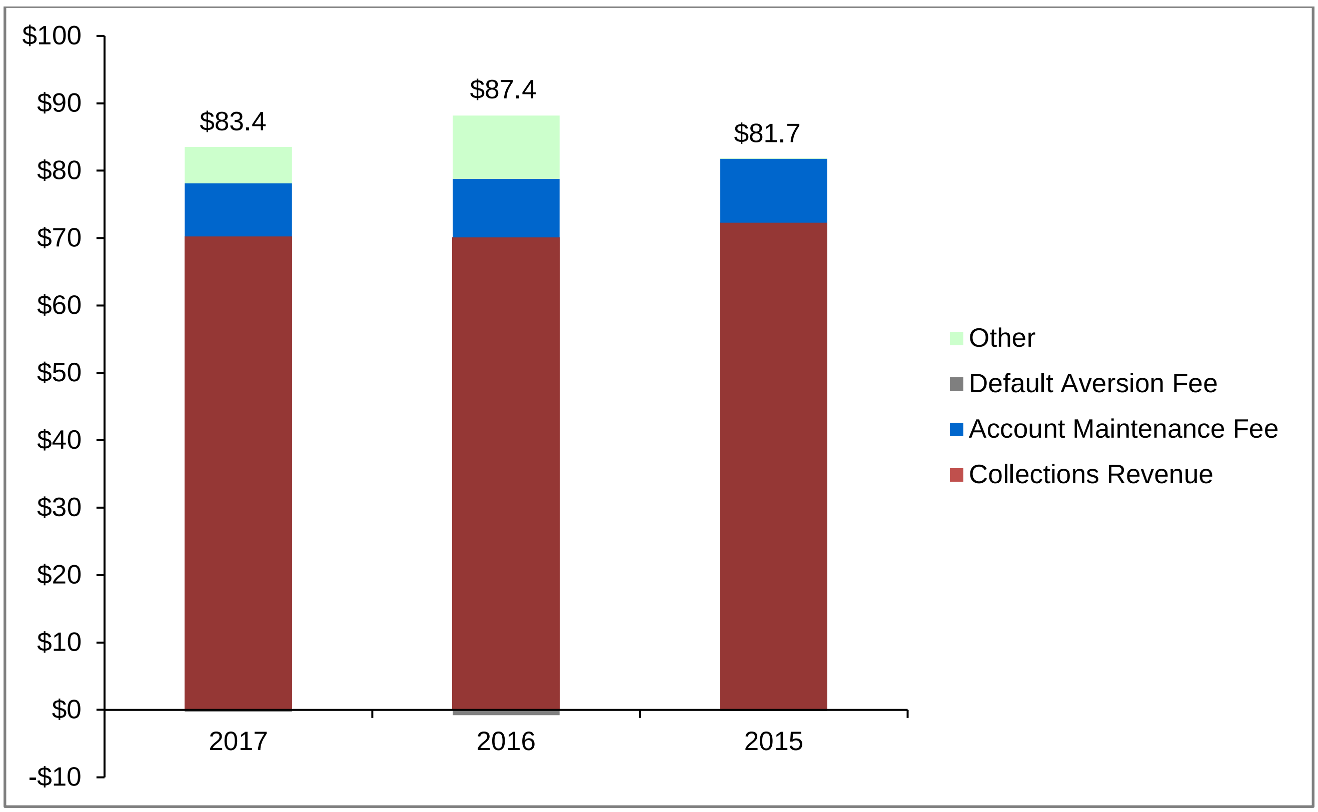
Condensed financial information

Dollar in thousands

		Operating fund			Federal fund	
	2017	2016	2015	2017	2016	2015
Current assets	$ 74,180	70,030	73,673	66,562	51,935	46,696
Capital assets	—	10	62	—	—	—
Other noncurrent assets	—	—	—	1,606	2,256	2,395
Total assets	$ 74,180	70,040	73,735	68,168	54,191	49,091
Deferred outflow of resources	$ 8,296	2,993	—	—	—	—
Current liabilities	$ 12,554	14,147	14,602	461	585	4
Noncurrent liabilities	10,946	6,356	4,804	—	—	—
Total liabilities	$ 23,500	20,503	19,406	461	585	4
Deferred inflow of resources	876	—	—	—	—	—
Net position:						
Invested in capital assets	$ —	10	62	—	—	—
Restricted	50,921	50,871	54,177	67,707	53,606	49,087
Unrestricted	7,179	1,649	—	—	—	—
Total net position	$ 58,100	52,530	54,239	67,707	53,606	49,087
Operating revenues:						
Defaulted loan collections	$ 70,225	70,093	72,288	278,672	263,142	254,507
Reimbursement of defaulted loans	—	—	—	356,255	385,761	421,649
Other operating revenues	8,700	8,978	9,350	260	783	188
Non-operating revenues	4,505	8,343	61	197	58	17
Total revenues	$ 83,430	87,414	81,699	635,384	649,744	676,361
Operating expenses:						
Administrative	54,684	51,868	55,137	—	—	—
Default loan purchases	—	—	—	355,249	394,742	437,827
Collection payments to ED	—	—	—	266,027	250,470	242,301
Other	1,055	1,107	91	6	13	10
Non-operating expenses	22,121	36,148	41,383	—	—	—
Total expenses	$ 77,860	89,123	96,611	621,282	645,225	680,138
Increase (decrease) in net position	$ 5,570	(1,709)	(14,912)	14,102	4,519	(3,777)

Total Operating Fund Revenue

(Dollar in millions)



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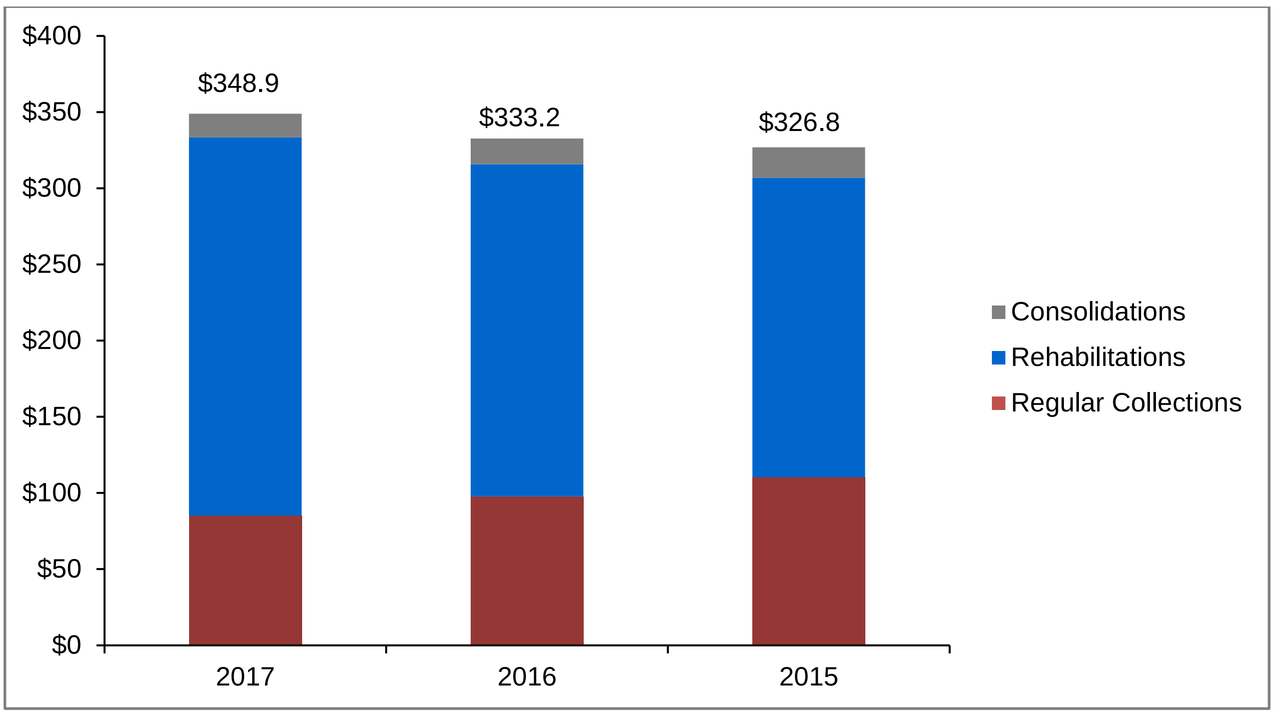
Operating Fund Revenue Highlights for fiscal year ending March 31

2017	2016
• Collections revenue represents 84% of total revenue as a result of the decrease of nonoperating revenue in 2016-2017. • Account maintenance fee income decreased by $0.8 million as a result of a decrease in outstanding principal balance of loans outstanding due to loans being paid by borrowers. • Default aversion fee (DAF) revenue decreased $0.7 million resulting in $0.3 million expense due back to the Federal Fund as a result of DAF refunds exceeding the DAF revenue for the year. • Other revenue includes $1 million in Treasury offset refunds revenue which is 100% offset by the expense of payments to borrowers in 2016-2017.	• Collections revenue represents 80% of total revenue as a result of the inclusion of Federal grant award revenues reported as other revenue in 2015-2016. • Account maintenance fee income decreased by $0.8 million as a result of a decrease in outstanding principal balance of loans outstanding due to loans being paid by borrowers. • Default aversion fee (DAF) revenue decreased $0.6 million resulting in $0.8 million expense due back to the Federal Fund as a result of DAF refunds exceeding the DAF revenue for the year. • Other revenue includes $1.1 million in Treasury offset refunds revenue which is 100% offset by the expense of payments to borrowers in 2015-2016.

Total Default Collection Recoveries

(Dollar in millions)



HESC's primary source of revenue continues to be from FFELP collection related activity. As a FFELP guarantor, HESC retains a percentage of collection recoveries determined by the Federal Department of Education.

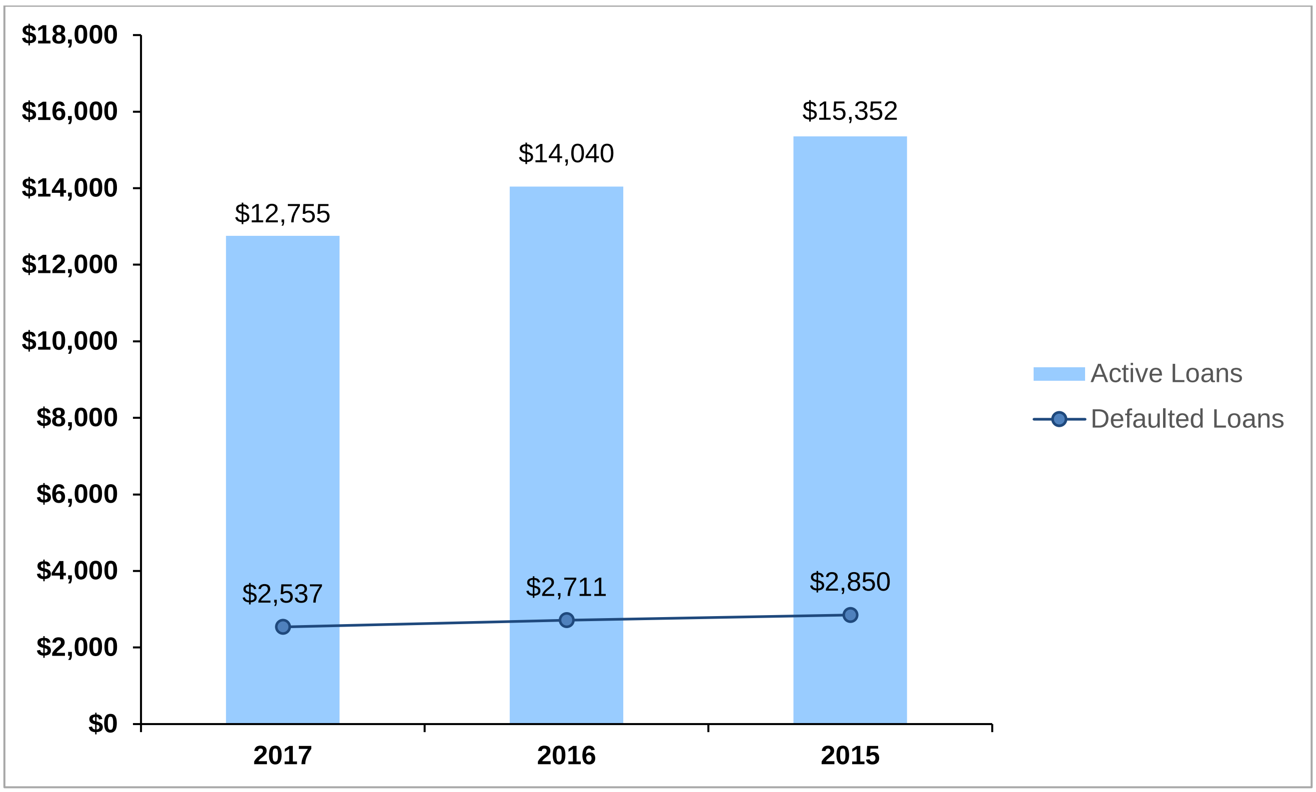
Collection Recovery Highlights for the fiscal year ending March 31

2017	2016
• Collections on rehabilitated loans increased $30 million or 14% to $248 million in 2016-2017 from a total of $218 million in 2015-2016. • Total regular collections decreased $13 million or 13% from $98 million in 2016 to $85 million in 2017. All sources of regular collection recoveries decreased in 2017 as a result of a 10% decrease in the collectible default portfolio. • Federal direct default consolidation revenue decreased 6% in 2017 to $16 million from $17 million in 2016.	• Collections on rehabilitated loans increased 11% to $218 million from a total of $197 million in 2014-2015. • Total regular collections decreased $12 million or 11% from $110 million in 2015 to $98 million in 2016, as a result of decreased vendor collections, state tax offsets and garnishment collections received during the fiscal year. • Federal direct default consolidation revenue decreased in 2016 to $17 million or 15% from $20 million in 2015.

Operating Fund Administration Revenue on Guaranteed FFEL Loans

Outstanding Portfolio Balances

(Dollar in millions)

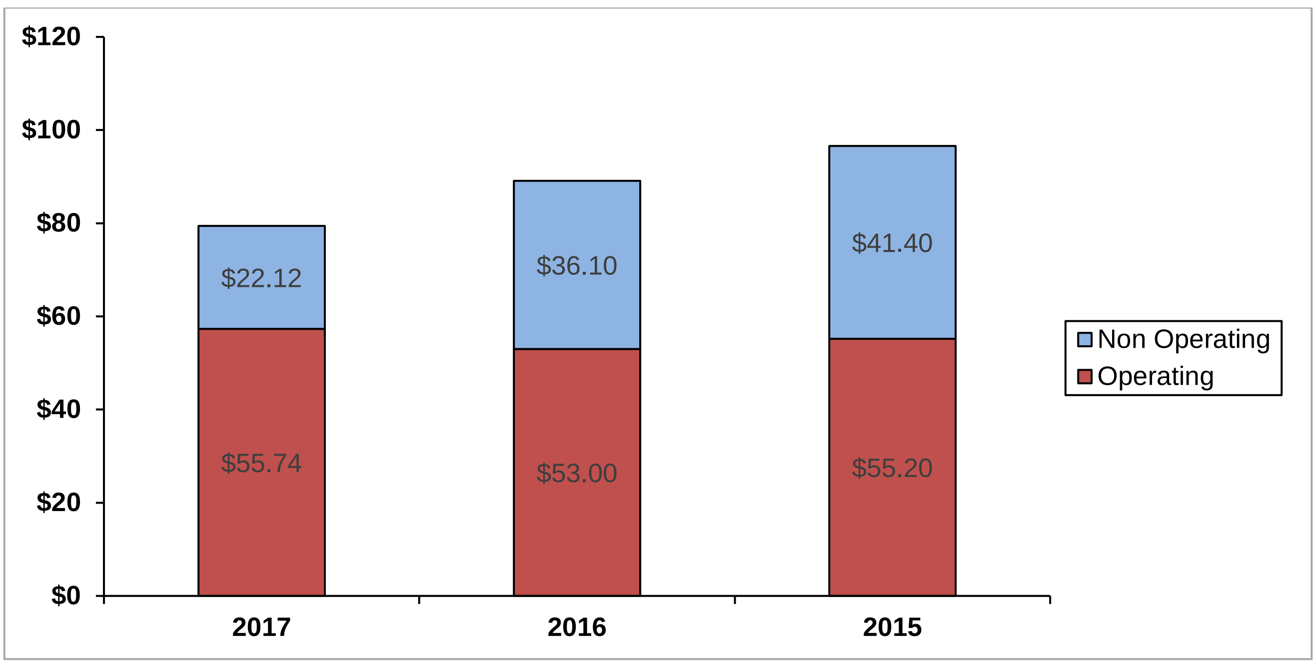


Administrative Revenue Highlights for the fiscal year ending March 31

2017	2016
• HESC's outstanding active portfolio balance decreased by $1.3 billion or 9% for the fiscal year as a result of active loans being paid in full during the year and no new loans being put into the portfolio, causing a decrease in account maintenance fee income of $0.8 million. • HESC's outstanding default portfolio decreased $0.2 billion during the fiscal year as a result of the aging portfolio.	• HESC's outstanding active portfolio balance decreased by $1.3 billion or 8% for the fiscal year as a result of active loans being paid in full during the year and no new loans being put into the portfolio, causing a decrease in account maintenance fee income of $0.8 million. • HESC's outstanding default portfolio decreased $0.1 billion during the fiscal year as a result of the aging portfolio.

Total Operating Fund Expenses

(Dollar in millions)



Operating Expense Highlights for fiscal year ending March 31

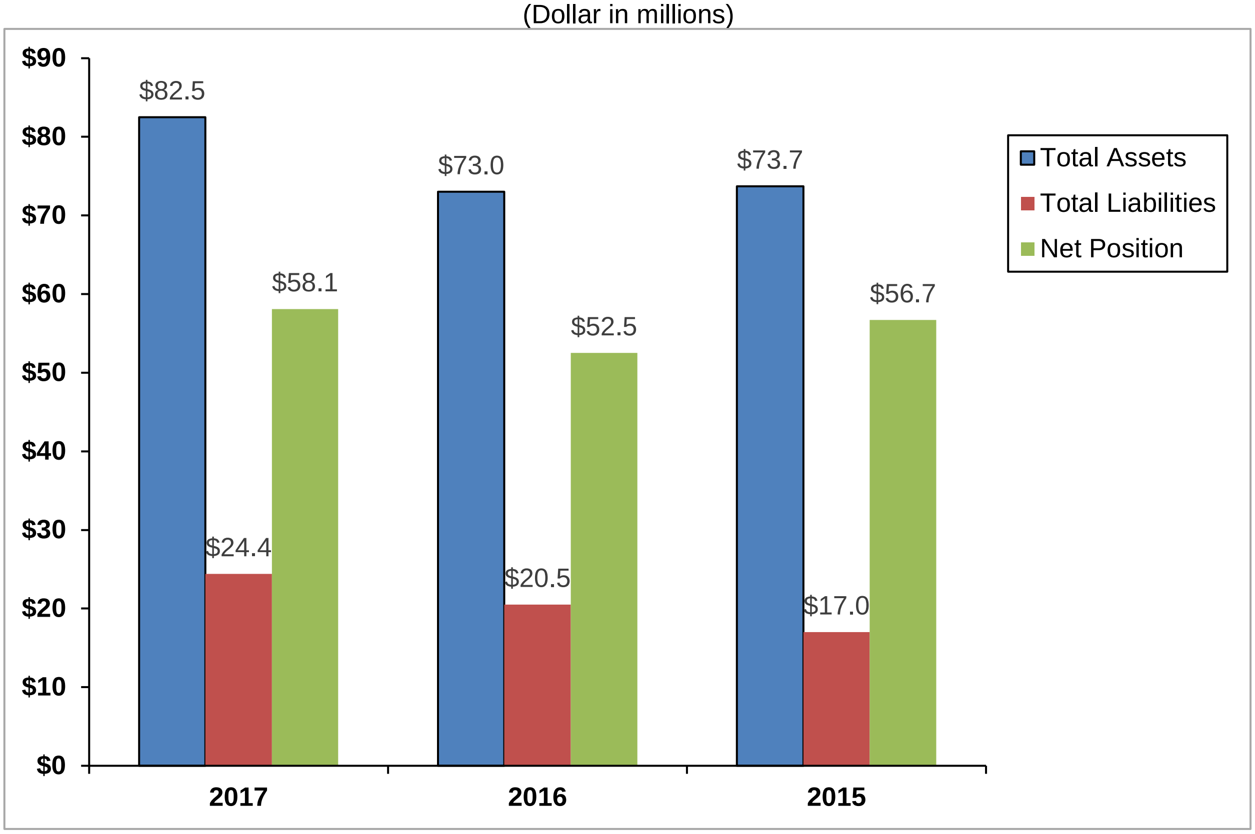
2017	2016
Operating Expenses • Outsourced vendor collection fees increased $5.3 million or 25% as a result of both an increase in vendor collection recoveries of $19.5 million. • Payroll and fringe benefit expense decreased by $281 thousand or 1.7%. The decrease in personal service is due to decreased full time equivalents from 239 in 2016 to 198 in 2017, offset by an increase in union salary rates and the addition of executive level employees. • NYS Servicing and ITS data center expense decreased $2.1 million or 22% from $9.6 million in 2015-2016 to $7.5 million in 2016-2017 as a result of a change in the allocation percentage between FFELP and Grants and Scholarships. • Other expense includes $1.0 million of Treasury offset refunds sent to borrowers which is 100% reimbursed by the Federal Department of Education.	**Operating Expenses** • Outsourced vendor collection fees increased $1.8 million or 9.7% as a result of increased collections attributable to outside collection agencies. • Payroll and fringe benefit expense decreased by $3.9 million or 14.7%. The savings achieved by the reduction in full time equivalents from 267 in 2014-2015 to 239 in 2015-2016 was offset by the additional costs of $1.5 million associated with the implementation of GASB No. 68 – *Accounting and Financial Reporting for Pensions*. • ITS data center expense increased 58% from $1.2 million in 2014-2015 to $1.9 million in 2015-2016. • Other expense includes $1.1 million of Treasury offset refunds sent to borrowers which is 100% reimbursed by the Federal Department of Education.

(Continued)

2017	2016
Nonoperating Expenses • The Operating Fund was not required to subsidize the Tuition Assistance Program in 2017. • Grant and scholarship program expense, excluding the 2015-2016 TAP offset of $16 million, increased $5.4 million in 2016-2017. NYS Servicing costs increased $3.6 million primarily due to an updated cost allocation based upon time and effort between Grant and Scholarships and the FFELP for costs associated with infrastructure and telephone expenses. In addition, personal service and fringe benefits increased $0.9 million. • The New York State Monitoring Program creates supportive mentor relationships for students at risk of dropping out of school. Costs are expected to be approximately $1.0 million each year. The Mentoring Program was fully instituted in 2016-2017, increasing costs by $0.7 million. • Federal grant expense of $4.9 million includes $4.3 million in payments to grantees which are 100% reimbursed by the Federal Grant. HESC paid administrative expenses of $0.6 million in 2016-2017.	**Nonoperating Expenses** • The Operating Fund contributed $16 million to subsidize the Tuition Assistance Program. • Grant and scholarship program expenses increased $2.5 million, as a result of the reclassification of ITS expenses for the 2015-2016 year from NYS Servicing Expense to program expense. • HESC expenses related to NYHELPs increased $0.08 million, a 94.4% increase due to aversion and collection activity on accounts. • Federal grant expense of $9.1 million includes $8.2 million in payments to grantees which are 100% reimbursed by the Federal Grant. HESC continues to pay administrative expenses of $0.8 million.

Operating Fund Assets and Liabilities

(Dollar in millions)



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Assets

- Total operating fund assets are primarily current assets, consisting of cash and cash equivalents, receivables due from the U.S. Department of Education and the Federal Fund.
- Total assets increased $9.5 million or 13% in 2016-2017, primarily due to an increase in cash from operational activities of $23.0 million, partially offset by the cash out flow from noncapital financial activities of $17.3 million. In addition, HESC receivables decreased $1.7 million during the state fiscal year 2016-2017.

Deferred Outflows of Resources

- Deferred outflows of resources for payments related to pensions subsequent to the associated measurement date increased $5.3 million in 2016-2017.

Liabilities

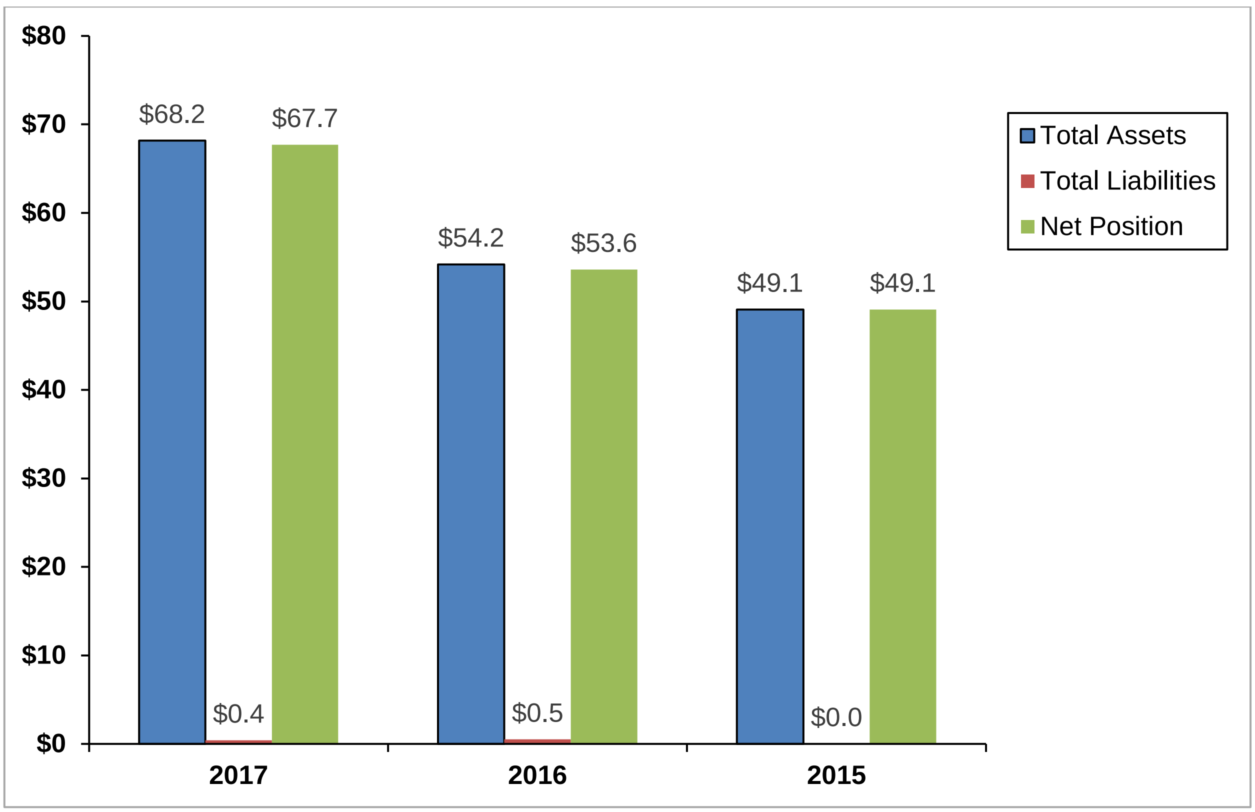
- Accounts payable and accrued liabilities represented 52% and 69% of total liabilities for the state fiscal years 2016-2017 and 2015-2016 respectively.
- Noncurrent liabilities increased $4.6 million, as a result of increased pension liability.

Net Position

- Net position increased $5.6 million or 10.7% due to net operating income exceeding net non-operating expenses.

The Federal Student Loan Reserve Fund (Federal Fund)

(Dollar in millions)



The Federal Fund assets are owned by the U.S. Department of Education and have restricted use, primarily to reimburse lender claims for defaulted student loans.

Assets

- The Federal Fund cash and cash equivalents decreased $7.7 million or 15% in fiscal year 2016-2017 as a result of a cash outflow of $7.9 million from operations.
- Total assets increased $14.0 million as a result of increased receivables from U.S. Department of Education in the amount of $22.5 million and the decrease in cash and cash equivalents of $7.7 million.
- Noncurrent assets decreased $0.6 million as a result of decreased default aversion fee revenue and estimated future returns.

Liabilities

- HESC current liabilities for the fiscal year 2016-2017 represent amounts due to Operating Fund for default collections and aversion fees.

Net Position

- Net position increased $14.1 million or 26% in 2016-2017 as a result of a decrease in default purchases from lenders of and an increase in default loan collections to ED.

Significant Known Facts, Decisions and Conditions

The Operating Fund will continue to support the operational expenses of the grant and scholarship programs in the amount of approximately $20 million for state fiscal year ended March 31, 2018.

Contacting Financial Management

This financial report is designed to provide our customers, business partners and creditors with a general overview of the Guaranteed Student Loan Programs' finances. For detailed information regarding the Federal Family Education Loan Program, you may also review our annual report on the web at www.hesc.ny.gov.

Questions about this report can be directed to HESC's Chief Financial Officer, Warren Wallin at (518) 486-7443 or Warren.Wallin@hesc.ny.gov.

THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

(A Component Unit of the State of New York)

Statements of Net Position

March 31, 2017 and 2016

	2017		2016	
Assets and Deferred Outflows of Resources	**Operating fund**	**Federal fund**	**Operating fund**	**Federal fund**
Current assets:				
Cash and cash equivalents (note 4)	$ 71,304,308	44,190,768	65,504,010	51,935,055
Receivables due from U.S. Department of Education:				
Administrative fees (note 5)	1,901,881	—	2,097,542	—
Reinsurance	—	22,340,007	—	—
Interfund balances (note 6)	460,420	—	381,204	—
Prepaid expenses and other assets	279,355	30,817	291,794	337
Due from Federal Government	234,254	—	1,755,724	—
Total current assets	74,180,218	66,561,592	70,030,274	51,935,392
Noncurrent assets:				
Interfund default aversion fee allowance (note 5)	—	1,606,064	—	2,255,868
Capital assets, net	—	—	10,001	—
Total noncurrent assets	—	1,606,064	10,001	2,255,868
Total assets	74,180,218	68,167,656	70,040,275	54,191,260
Deferred outflows of resources related to pensions (note 8)	8,295,734	—	2,992,516	—
Total assets and deferred outflows of resources	$ 82,475,952	68,167,656	73,032,791	54,191,260
Liabilities, Deferred Inflows of Resources and Net Position				
Current liabilities:				
Accounts payable and accrued liabilities	$ 12,528,544	—	14,117,979	88
Interfund balances (note 6)	—	460,420	—	381,204
Amounts payable to schools	25,513	—	28,744	—
Reinsurance due to U.S. Department of Education	—	—	—	204,198
Total current liabilities	12,554,057	460,420	14,146,723	585,490
Noncurrent liabilities:				
Pension contributions payable (note 8)	2,160,376	—	2,450,552	—
Net pension liability (note 8)	7,179,512	—	1,649,233	—
Interfund default aversion fee allowance (note 5)	1,606,064	—	2,255,868	—
Total noncurrent liabilities	10,945,952	—	6,355,653	—
Total liabilities	23,500,009	460,420	20,502,376	585,490
Deferred inflows of resources related to pensions (note 8)	875,744	—	—	—
Total liabilities and deferred inflows of resources	24,375,753	460,420	20,502,376	585,490
Net position:				
Invested in capital assets	—	—	10,001	—
Restricted – property of U.S. Department of Education	—	67,707,236	—	53,605,770
Restricted – for student aid related activities	58,100,199	—	50,871,181	—
Unrestricted	—	—	1,649,233	—
Total net position	58,100,199	67,707,236	52,530,415	53,605,770
Total liabilities, deferred inflows of resources and net position	$ 82,475,952	68,167,656	73,032,791	54,191,260

See accompanying notes to financial statements.

THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION
(A Component Unit of the State of New York)

Statements of Revenue, Expenses, and Changes in Net Position

Years ended March 31, 2017 and 2016

	2017		2016	
	Operating fund	**Federal fund**	**Operating fund**	**Federal fund**
Operating revenues:				
Defaulted loan collections (note 2(e))	$ 70,225,406	278,672,059	70,093,036	263,141,717
Administrative and program fee income (note 5)	7,649,590	—	7,897,638	—
Reimbursement on purchases of default loans from lenders (note 2(f))	—	356,254,918	—	385,760,682
Default aversion fee subsidy	—	259,655	—	783,433
Other revenue	1,049,887	6	1,080,532	—
Total operating revenues	78,924,883	635,186,638	79,071,206	649,685,832
Operating expenses:				
Salaries and employee benefits	16,088,965	—	16,370,058	—
General and administrative	5,335,361	—	5,429,768	—
Collection vendors	25,820,487	—	20,505,539	—
NYS servicing	6,066,929	—	7,701,565	—
NYS Information Technology Services infrastructure	1,372,381	—	1,860,522	—
Purchases of default loans from lenders (note 2 (f))	—	355,249,156	—	394,742,656
Defaulted loan collections paid to U.S. Department of Education (note 2(e))	—	266,027,098	—	250,469,572
Depreciation	10,001	—	52,300	—
Other expense	1,045,624	5,532	1,054,946	12,959
Total operating expenses	55,739,748	621,281,786	52,974,698	645,225,187
Operating income	23,185,135	13,904,852	26,096,508	4,460,645
Nonoperating revenues (expenses):				
Interest income	169,451	196,614	101,052	58,017
Federal grant revenue	4,335,910	—	8,241,595	—
Federal grant administrative expenses	(4,944,383)	—	(9,065,211)	—
New York State initiatives (note 7)	(17,176,329)	—	(27,083,250)	—
Total nonoperating (expenses) revenues	(17,615,351)	196,614	(27,805,814)	58,017
Increase (decrease) in net assets	5,569,784	14,101,466	(1,709,306)	4,518,662
Net position, beginning	52,530,415	53,605,770	54,239,721	49,087,108
Net position, ending	$ 58,100,199	67,707,236	52,530,415	53,605,770

See accompanying notes to financial statements.

THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION
(A Component Unit of the State of New York)

Statements of Cash Flows

Years ended March 31, 2017 and 2016

	2017		2016	
	Operating fund	**Federal fund**	**Operating fund**	**Federal fund**
Cash flows from operating activities:				
Receipts from:				
Collections	$ 69,780,772	278,686,997	69,061,657	264,218,274
Administrative fees	7,131,168	—	8,088,751	—
Other sources	1,049,887	—	1,285,101	—
Reimbursement on purchases of default loan purchases	—	342,397,669	—	391,781,346
Federal default aversion fee income	—	973,738	—	791,804
Payments for:				
Salaries and employee benefits	(11,270,966)	—	(17,219,192)	—
Purchases of default loans from lenders	—	(363,932,333)	—	(394,742,656)
Collections paid to U.S. Department of Education	—	(266,030,966)	—	(250,577,270)
General, administrative and other expenses	(43,771,917)	(5,526)	(38,111,370)	(12,959)
Net cash provided by (used in) operating activities	22,918,944	(7,910,421)	23,104,947	11,458,539
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(17,288,538)	—	(28,024,801)	—
Net cash used in noncapital financing activities	(17,288,538)	—	(28,024,801)	—
Cash flows from investing activities:				
Interest received	169,892	166,134	100,763	57,797
Net cash provided by investing activities	169,892	166,134	100,763	57,797
Increase (decrease) in cash and cash equivalents	5,800,298	(7,744,287)	(4,819,091)	11,516,336
Cash and cash equivalents, beginning	65,504,010	51,935,055	70,323,101	40,418,719
Cash and cash equivalents, ending	$ 71,304,308	44,190,768	65,504,010	51,935,055
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	$ 23,185,135	13,904,852	26,096,508	4,460,645
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation	10,001	—	52,300	—
Change in assets and liabilities that provided (used) cash:				
Receivables from U.S. Department of Education	195,661	(22,544,205)	199,484	5,917,032
Other assets	11,998	—	(993,859)	—
Interfund balances	(79,216)	79,216	(945,629)	945,629
Accounts payable and accrued liabilities and other liabilities	(567,460)	(88)	(64,116)	(4,066)
Allowance for default aversion refunds	(649,804)	649,804	(139,299)	139,299
Net pension liability, net of deferred outflows of resources	812,629	—	(1,100,442)	—
Total adjustments	(266,191)	(21,815,273)	(2,991,561)	6,997,894
Net cash provided by (used in) operating activities	$ 22,918,944	(7,910,421)	23,104,947	11,458,539

See accompanying notes to financial statements.

(1) Organization and Operations

New York State Higher Education Services Corporation (HESC) is an agency of New York State (the State) created in 1974 under Chapter 942 of the Laws of 1974 and is responsible for the administration of the State's student financial aid programs, including the Federal Family Education Loan Program (FFELP) and State loan guarantee program.

FFELP was established by Congress and is administered by the U.S. Department of Education through HESC and other guaranty agencies. As a guaranty agency, HESC made loans available through lending institutions to students attending colleges, universities, and postsecondary educational and vocational schools. FFELP allows HESC to guarantee repayment of principal and accrued interest to lenders for eligible student loans. HESC has the responsibility of providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, and performing certain collection activities on loans after purchase by HESC. In addition to FFELP, the Guaranteed Student Loan Programs include the residual activity of the State guaranteed loan program under which no new loans have been guaranteed since 1984.

On March 30, 2010, the President signed into law H.R. 4872 – The Health Care and Education Reconciliation Act of 2010 (HCERA), which terminated new loan originations in FFELP on June 30, 2010. Effective July 1, 2010, all new Stafford, PLUS or consolidated loans are originated under the U.S. Department of Education Direct Loan Program. Existing FFELP loans will continue to be eligible for program benefits. The Guaranteed Student Loan Programs' Operating Fund and Federal Fund of HESC continue to administer its existing FFELP portfolio of both active and defaulted student loans.

The accompanying financial statements reflect the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of HESC. The Federal Fund assets, and earnings on those assets, are restricted in use and are property of the U.S. Department of Education. The Operating Fund is property of HESC and its assets and earnings are restricted in use for student financial aid related activities as required by the Higher Education Amendments of 1998.

HESC also administers the Tuition Assistance Program, and State Scholarship Programs, under which students apply for payments to attend eligible educational institutions based on family income and/or academic achievement. In addition, HESC partners with colleges, universities, school districts and other educational organizations in administering the Gaining Early Awareness and Readiness for Undergraduate Programs and College Access and Challenge Grant, which are designed to increase the number of low income students who are prepared to enter and succeed in postsecondary education. These programs are included in the accompanying financial statements as non-operating revenues and expenses.

(Continued)

(2) Significant Accounting Policies

(a) Basis of Accounting

The Guaranteed Student Loan Programs' Operating Fund and Federal Fund of the New York State Higher Education Services Corporation are prepared under U.S. generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). The Guaranteed Student Loan Programs' Operating Fund and Federal Fund follow fund accounting under which resources are classified for accounting and reporting purposes into funds established according to their purpose. The Federal Fund finances FFELP insurance activities, while the Operating Fund accounts for substantially all FFELP operational costs as well as financial aid awareness and related outreach activities. The two funds together constitute the Guaranteed Student Loan Programs and are accounted for as business-type activities using the flow of economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the cost is incurred regardless of the timing of the related cash flow.

(b) Cash and Cash Equivalents

Cash and cash equivalents, consisting of United States Treasury Bills and collateralized short-term repurchase agreements with original maturities of 90 days or less, are carried at amortized cost. Investment income represents interest on deposits and gains and losses.

(c) Net Position

HESC's net position is classified in the following categories: invested in capital assets, consisting of capital assets, net of accumulated depreciation; restricted – property of U.S. Department of Education, consisting of restricted assets reduced by related liabilities belonging to the U.S. Department of Education; and restricted – for student aid related activities, consisting of assets reduced by related liabilities that are not classified as invested in capital assets or restricted – property of U.S. Department of Education.

(d) Operating Revenues and Expenses

Operating revenues and expenses result generally from activities associated with FFELP, including collection on defaulted loans, default prevention, and default loan purchase activities. All revenues and expenses not derived from the administration of FFELP are reported as nonoperating revenues and expenses.

(e) Collections on Defaulted Loans

HESC management is required by Federal statutes to pursue collections on loans upon default claim payment. Collections on defaulted loans and related complements are recorded at the time such collections are received. Through December 31, 2015, all collection receipts were initially deposited in the Operating Fund and daily estimated collection transfers were made to the Federal Fund. Effective January 1, 2016, HESC established a Federal Fund Suspense account where all deposits are made and daily estimated collections transfers are made to both the Federal Fund and Operating Fund. The Operating Fund retains 16% of borrower payments and rehabilitation collections and 10% of principal and interest at the time of consolidation.

(f) Purchase of Defaulted Federal Loans

Purchases of defaulted loans and amounts repurchased by lenders are recorded as Federal Fund activity. The reinsurance reimbursement results in a net reduction to the Federal Fund for default purchases completed prior to December 1, 2015, due to reduced reinsurance rates of 98% and 95% as a result of various amendments to the Higher Education Act. The Higher Education Act was amended during the March 31, 2016 state fiscal year to repeal the reduced reinsurance rates for Guaranty Agencies. As a result of the amendment, all claims are reimbursed at 100% effective December 2015.

FFELP claims are paid to lenders and servicers at 100%, 98% or 97% of the claim value depending on the claim reason and date of original loan disbursement. As of March 2017, HESC was processing claims for 11 servicers and 5 lenders.

(g) Income Taxes

HESC is a component unit of the State of New York and is generally exempt from Federal, State, and Local income taxes.

(h) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting periods. Management estimates include default aversion fee refunds, net pension liability, and accrued expenses. Actual results could differ from those estimates.

(i) Adoption of New Accounting Pronouncements

HESC implemented GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72) during fiscal year March 31, 2017. GASB 72 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain

(Continued)

investments and disclosures related to all fair value measurements. The effect of GASB 72 requirements can be found in note 4.

(3) Guaranteed Loans Outstanding and Respective Unpaid Balances

As of March 31, 2017 and 2016, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately $12,755,000,000 and $14,040,000,000, respectively, made to students by participating lending institutions. A substantial portion of that amount is guaranteed by the U.S. Department of Education, with an amount representing less than 1% guaranteed by the State. At March 31, 2017 and 2016, the unpaid balances were approximately $9,663,000,000 and $10,841,000,000, respectively.

HESC's management anticipates that a certain portion of the loans outstanding will go into default status, requiring the Federal Fund to purchase loans from lenders. Because the majority of these loans are federally guaranteed, the Federal Fund will be reimbursed by the U.S. Department of Education.

(4) Cash and Cash Equivalents

Cash equivalents are short-term investments with original maturities of three months or less when purchased. Federal Fund amounts are restricted in use and are property of the U.S. Department of Education. HESC actively manages the investment of its cash balances to minimize its uninvested funds. Cash balances in an administrative account in the Operating Fund are invested in the New York State Comptroller's short-term investment pool and are recorded at amortized cost at March 31, 2017. These cash balances are available to HESC upon demand.

Custodial credit risk for cash and cash equivalents is the risk that in the event of the failure of the counterparty to a transaction, HESC will not be able to recover the value of cash and cash equivalents that are in the possession of an outside party. In order to manage this risk, HESC requires collateral consisting of Federal government obligations or agency instruments guaranteed by the Federal government pursuant to its investments in repurchase agreements and delivery to its Trustee (agent) of all securities purchased and collateral for repurchase agreements, regardless of the seller institution. To manage custodial credit risk on deposits, HESC requires that its depository banks pledge collateral based on available bank balances. Additionally, HESC's investment policy limits the amount of funds which may be invested at any given dealer to $125 million.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a cash equivalent. HESC's policy for managing this risk is to hold cash equivalents to maturity, at which time the fair value of the investment is equal to its stated maturity value.

Fair Value

GASB 72 establishes a three-level valuation hierarchy for fair value measurements. This valuation hierarchy is based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions and other inputs subject to management judgment.

HESC did not have any investments measured at fair value as of March 31, 2017 and March 31, 2016.

Cash and cash equivalents at March 31 were as follows:

		2017	2016
Operating Fund:			
Repurchase agreements	$	—	63,518,645
Cash in State Comptroller's short-term investment pool and cash in bank		71,304,308	1,985,365
Operating Fund cash and cash equivalents	$	71,304,308	65,504,010
Federal Fund:			
Repurchase agreements	$	—	48,473,981
Cash and cash equivalents		44,190,768	3,461,074
Federal Fund cash and cash equivalents	$	44,190,768	51,935,055

(5) Operating Administrative Fees

The 1998 Higher Education Act Amendments established two fees recorded in the Operating Fund for administering the loan program on behalf of the Federal Government based on performance as a guaranty agency.

A Default Aversion Fee is recognized for default aversion activities on delinquent loans at the time the lenders request aversion assistance between the 60th and 120th days of a borrower's delinquency. A fee of 1% of principal and interest on the loan may be charged to the Federal Fund at the time the guaranty agency receives a request from a lender for preclaim assistance. However, the fee must be refunded by the Operating Fund to the Federal Fund in the event the loan is later paid as a default claim. Accordingly, an estimate of default aversion fee refunds of $1,606,064 and $2,255,868 at March 31, 2017 and 2016, respectively, is reported as a liability in the Operating Fund and a receivable in the Federal Fund. The net default aversion fee is transferred from the Federal Fund to the Operating Fund on a monthly basis.

An Account Maintenance Fee is calculated on the original principal amount of loans outstanding at a rate of 0.06%. This fee is paid to the Operating Fund either directly by the U.S. Department of Education or as an authorized transfer from the Federal Fund on a quarterly basis.

For the years ended March 31, 2017 and 2016, the administrative fees receivable from U.S. Department of Education consisted of the following:

		2017	2016
Operating Fund:			
Account maintenance fee receivable	$	1,901,881	2,097,542

For the years ended March 31, 2017 and 2016, administrative fee income is as follows:

		2017	2016
Operating Fund:			
Default aversion fee subsidy, net of estimated refunds	$	(259,655)	(783,433)
Account maintenance fee		7,909,245	8,681,071
Total administrative and program fee income	$	7,649,590	7,897,638

Gross default aversion fee income for the years ended March 31, 2017 and 2016 was $1,203,704 and $1,916,267, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2017 and 2016, the default aversion fee allowance estimate was 110% and 117% of default aversion fee income, respectively. The estimate of the refunds for 2017 is based on the three year average change in actual refunds applied to current year refunds. As the portfolio ages without new loans being added the refunds are exceeding revenue as revenue declines.

(6) Interfund Balances

Interfund balances are monies due to and/or due from the Federal Fund to the Operating Fund and includes collection transfer balances and default aversion fees pending transfer. A daily transfer between funds is made based on an estimate of U.S. Department of Education's equitable share of daily collections. A final settlement for the actual amount of collections due to the Federal Fund is made at month end.

At March 31, 2017, the Operating Fund had a net interfund receivable balance of $460,420 consisting of a receivable from the Federal Fund for overpayment of collections for the month of $492,091 and an interfund default aversion payable of $31,672. At March 31, 2016, the interfund receivable consisted of an overpayment of collections activity of $477,154 and a default aversion fee receivable of $95,950.

(7) New York State Initiatives

The New York State budget required the Operating Fund to pay the operational expenses related to the administration of the State's grant and scholarship programs, which amounted to $16,352,326 and $10,903,738 in the years ended March 31, 2017 and 2016, respectively.

The New York State budget for the state fiscal year ended March 31, 2016 appropriated $16,000,000 of operating funds to subsidize the Tuition Assistance Program (TAP). There was no budget appropriation for TAP in state fiscal year ended March 31, 2017.

In the years ended March 31, 2017 and 2016, HESC's Operating Fund incurred costs of $69,836 and $169,025, respectively, for costs associated with administering the New York Higher Education Loan Program (NYHELPs).

HESC's Operating Fund incurred costs for the administration of the college savings program during state fiscal years ended March 31, 2017 and 2016 in the amounts of $31,319 and $10,487, respectively.

HESC's Operating Fund incurred costs for the administration of the New York State Mentoring Program during the state fiscal year ended March 31, 2017 and 2016 of $722,848 and $0, respectively.

The activities of these State programs are included in the accompanying financial statements as non-operating activities.

(8) Retirement Plan

(a) General Information

Substantially all employees working for the Guaranteed Student Loan Programs are members of the New York State Employees' Retirement System (the "System"), a defined-benefit cost-sharing, multiple-employer public employee retirement system. The net position of the System is held in the New York State Common Retirement Fund (Fund), which was established to hold all net assets and recorded changes in fiduciary net position allocated to the System. System benefits and required contributions are established under the provisions of the New York State Retirement and Social Security Law (NYSRSSL). As set forth in the NYSRSSL, the State Comptroller serves as sole trustee and administrative head of the System. The Comptroller promulgates rules and regulations for the administration and transaction of the business of the System and for the custody and control of its monies. The System offers a range of programs and benefits that vary based on the date of membership, years of credited service and final average salary, vesting of retirement benefits, disability benefits and optional methods of benefit payments. Once a public employer elects to participate in the System, the election is irrevocable. The System issues a publicly available financial report that includes financial statements and required supplementary information which may be obtained by writing to the New York State and Local Employees' Retirement System, 110 State Street, Albany, New York 12236, or www.osc.state.ny.us/retire/publications/index.php.

(b) Plan Benefits

The System provides retirement benefits as well as death and disability benefits. All benefits vest after five years of accredited service. Retirement benefits and contributory requirements depend upon the point in time at which an employee last joined the System. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan. The Operating Fund contributes the entire amount determined to be payable to the System for these employees. Personnel who joined the System after July 27, 1976 are required by law to contribute some percentage of their gross salary for the first ten years of employment based upon the System's tier concept of distinct classes of membership. The Operating Fund contributes the balance payable to the System for these employees.

The System uses a tier concept to distinguish these groups, as follows:

Tier 1 Those persons who last became members before July 1, 1973.

Tier 2 Those persons who last became members on or after July 1, 1973, but before July 27, 1976.

Tier 3 Generally, those persons who are State correction officers who last became members on or after July 27, 1976, but before January 1, 2010, and all others who last became members on or after July 27, 1976, but before September 1, 1983.

Tier 4 Generally, except for correction officers, those persons who last became members on or after September 1, 1983, but before January 1, 2010.

Tier 5 Those persons who last became members on or after January 1, 2010, but before April 1, 2012.

Tier 6 Those persons who first became members on or after April 1, 2012.

Generally, members of the System must be at least age 55 to be eligible to collect a retirement benefit. There is no minimum service requirement for Tier 1 members. Full benefits may be collected at age 55 for Tier 1 members. Members of Tiers 2, 3 and 4 must generally have five years of service to be eligible to collect a retirement benefit. The full benefit age for members of Tiers 2, 3 and 4 is 62. Tier 5 members must have ten years of service to be eligible to collect a retirement benefit. The full benefit age for Tier 5 members is 62. Tier 6 members must have ten years of service to be eligible to collect a retirement benefit. The full benefit age for Tier 6 is 63. A member with less than five years of service may withdraw and obtain a refund, including interest, of the accumulated employee contributions. Members who joined the System prior to January 1, 2010 generally need five years of service to be 100% vested. Members who joined on or after January 1, 2010 need 10 years of service credit to be 100% vested.

Typically, the benefit for members in all Tiers within the System is 1.67% of final average salary for each year of service if the member retires with less than 20 years. If a Tier 1 or 2 member retires with 20 or more years of service, the benefit is 2% of final average salary for each year of service. If a Tier 3, 4 or 5 member retires with between 20 and 30 years of service, the benefit is 2% of final average salary for each year of service. If a Tier 3, 4 or 5 member retires with more than 30 years of service, an additional benefit of 1.5% of final average salary is applied for each year of service over 30 years. Final average salary for Tiers 1 through 5 is the average of the wages earned in the three highest consecutive years of employment. Each year used in the final average salary calculation is limited to no more than 20% of the previous year (Tier 1) or no more than 20% of the average of the previous two years (Tier 2). For Tier 3, 4 and 5 members, each year used in the final average salary calculation is limited to no more than 10% greater than the average of the previous two years. The benefit for Tier 6 members who retire with 20 years of service is 1.75% of final average salary for each year of service. If a Tier 6 member retires with more than 20 years of service, an additional benefit of 2% of final average salary is applied for each year of service over 20 years. The final average salary for a Tier 6 member is computed as the average of the wages earned in the five highest consecutive years. Each year of final average salary is limited to no more than 10% of the average of the previous four years.

(c) Contributions

System funding requirements are determined by the actuary of the System. The System calculates the employer contribution using the actuarially determined rates and salaries. Participating employers are required under the RSSL to contribute to the System at an actuarially determined rate adopted annually by the Comptroller. The contribution rate for HESC, made through the application of the pension benefit rate within the New York State Fringe Benefit rate calculated by the State's Division of the Budget for the year ended March 31, 2017 and 2016 was 16.47% and 16.73%, respectively, of covered payroll. HESC's contributions to the System for the years ended March 31, 2017 and March 31, 2016 were $2,096,423 and $2,263,283, respectively.

Under Chapter 49 of the Law of 2003, the annual contribution rates are based on the value of the State's Common Retirement Fund investments as of the preceding April, with a minimum contribution of 4.5%. RSSL Chapter 57 of the Laws of 2010 authorized the State and local employers to amortize over ten years, at 5% interest, a portion of their annual bill starting in the fiscal year ended 2011. Beginning in fiscal year 2011, the State has elected to defer a portion of its required employer contribution resulting in a pension contribution payable attributable to HESC as of March 31, 2017 of $2,447,984, of which $2,160,376 is in noncurrent liabilities and $287,608 is included in current liabilities. As of March 31, 2016, pension contribution payable attributable to HESC equaled $2,795,051, of which $2,450,552 was in noncurrent liabilities and $344,499 was included in current liabilities.

(Continued)

(d) Pension Liability, Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

HESC's proportionate share of the State's collective net pension liability of $7,179,512 reported at March 31, 2017, was measured as of March 31, 2016, and was determined using an actuarial valuation as of April 1, 2015, with update procedures used to roll forward the total pension liability to March 31, 2016. HESC's proportionate share of the State's collective net pension liability of $1,649,233 reported at March 31, 2016 was measured as of March 31, 2015, and was determined using an actuarial valuation as of April 1, 2014, with update procedures used to rollforward the total pension liability to March 31, 2015. The State's net pension liability was based on a projection of HESC's long-term share of contributions to the pension plan relative to the projected contributions of all participating members, actuarially determined. The State makes contributions to the System on behalf of HESC. HESC's proportionate share of the State's net pension liability is based on an allocation calculated using HESC's payroll as a percentage of the State's payroll. For purposes of determining net pension liability and other pension-related amounts, information about the fiduciary net position of the System and additions to and deductions from the System fiduciary net position have been determined on the same basis reported by the System. Benefits are recognized when due and payable. Investments are recorded at fair value.

At the measurement date of March 31, 2016, HESC's proportion of the net pension liability of ERS was 0.04473%, compared to 0.04882% at March 31, 2015.

For the year ended March 31, 2017, HESC recognized a pension expense of $3,142,346. At March 31, 2017, HESC reported the following deferred outflows of resources related to pension from the following sources:

		Deferred outflows of resources	Deferred inflows of resources
Difference between expected and actual experience	$	36,280	851,011
Net difference between projected and actual investment earnings on pension plan investments		4,259,280	—
Changes in proportion and differences between contributions and proportionate share of contributions		46,074	24,733
Changes of assumptions		1,914,559	—
Contributions made subsequent to measurement date		2,039,541	—
Total	$	8,295,734	875,744

For the year ended March 31, 2016, HESC recognized a pension expense of $1,504,623. At March 31, 2016, HESC reported the following deferred outflows of resources related to pension from the following sources:

	Deferred outflows of resources	Deferred inflows of resources
Difference between expected and actual experience	$ 52,794	—
Net difference between projected and actual investment earnings on pension plan investments	286,452	—
Changes in proportion and differences between contributions and proportionate share of contributions	48,205	—
Contributions made subsequent to measurement date	2,605,065	—
Total	$ 2,992,516	—

The amounts of deferred outflows of resources resulting from contributions made subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended March 31, 2018. The remaining cumulative net amounts reported as deferred outflows of resources and deferred inflow of resources related to pensions will be recognized in future pension expense as follows:

	Deferred outflows of resources
Year ending March 31:	
2018	$ 1,367,261
2019	1,367,261
2020	1,367,261
2021	1,278,666

(e) Actuarial Assumptions

The total pension liability at the measurement date of March 31, 2016 was determined by using an actuarial valuation as of April 1, 2015, with update procedures used to roll forward the total pension liability to March 31, 2016. Actuarial methods and assumptions for the System for the net pension liability measured at March 31, 2016 were:

Actuarial cost method	Entry age normal
Inflation	2.5%
Salary scale	3.8%, indexed by service
Investment rate of return, including inflation	7.0% compounded annually, net of investment expenses
Cost of living adjustments	1.3% annually
Decrements	Developed from each Plan's 2015 experience study for period April 1, 2010 through March 31, 2015
Mortality improvement	Society of Actuaries Scale MP-2014

The total pension liability for the March 31, 2015 measurement date was determined by using an actuarial valuation as of April 1, 2014, with update procedures used to roll forward the total pension liability to March 31, 2015. Actuarial methods and assumptions for the System for the prior year net pension liability measured at March 31, 2015 were:

Actuarial cost method	Entry age normal
Inflation	2.7%
Salary scale	4.9%, indexed by service
Investment rate of return, including inflation	7.5% compounded annually, net of investment expenses
Cost of living adjustments	1.4% annually
Decrements	Developed from each Plan's 2010 experience study for period April 1, 2005 through March 31, 2010
Mortality improvement	Society of Actuaries Scale MP-2014

(i) *Expected Rate of Return*

The long-term expected rate of return on pension plan investments was determined using a building block method in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation for the System as of April 1, 2015 and April 1, 2014 are summarized below:

Asset class	Target allocation	Long-term expected real rate of return
Domestic equity	38 %	7.30 %
International equity	13	8.55
Private equity	10	11.00
Real estate	8	8.25
Absolute return strategies	3	6.75
Opportunistic portfolio	3	8.60
Real assets	3	8.65
Bonds and mortgages	18	4.00
Cash	2	2.25
Inflation indexed bonds	2	4.00
	100 %	

(ii) *Discount Rate*

The discount rate used to calculate the total pension liability was 7.0% for the March 31, 2016 measurement date as compared to 7.5% for the March 31, 2015 measurement date. The projection of cash flows used to determine the discount rate assumes that contributions from plan members will be made at the current contribution rates and that contributions from employers will be made at statutorily required rates, actuarially determined. Based upon the assumptions, the System's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

(Continued)

The following presents the current period net pension liability of HESC calculated using the current period discount rate assumption of 7.0%, as well as what HESC's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.0%) or 1 percentage-point higher (8.0%) than the current assumption:

		1% Decrease (6.0%)	Current assumption (7.0%)	1% Increase (8.0%)
Proportionate share of the net pension liability (asset)	$	16,189,276	7,179,152	(433,355)

The following presents the prior period net pension liability of HESC calculated using the prior period discount rate assumption of 7.5%, as well as what HESC's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1% point lower(6.5%) or 1% point higher (8.5%) than the prior period assumption:

		1% Decrease (6.5%)	Prior period assumption (7.5%)	1% Increase (8.5%)
Proportionate share of the net pension liability (asset)	$	10,992,848	1,649,233	(6,239,096)

(9) Other Postretirement Benefits

As a State agency, HESC participates in the New York State Health Insurance Program (NYSHIP), which is administered by the State as an agent multiple employer defined benefit plan. The plan under the State provides certain healthcare benefits for eligible retired employees and their dependents under a single employer noncontributory healthcare plan. Article XI of the New York State Civil Service Law assigns the authority to NYSHIP to establish and amend the benefit provision of the plan and to establish maximum obligations of the plan members to contribute to the plan. The State's plan states that employees and/or their dependents become eligible for these benefits at 55 years of age when the employee has 10 years of State service. In calculating the 10 year service requirement, all of the employee's service need not be with the State, but may be a composite of State service and service in other qualified sectors. Employees with no prior State service must work a minimum of 10 years before they and their dependents are eligible for the retirement medical benefits. Eligible retirees are required to contribute to the cost of coverage for health insurance benefits, and the rates are based on the negotiated contract rates effective for single or dependent coverage at the time of retirement. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State.

During the fiscal year ended March 31, 2017, NYSHIP provided health insurance coverage through the Empire Plan, an indemnity health insurance plan with managed care components; 10 Health Maintenance

Organizations (HMOs); and through the Student Employee Health Plan (SEHP). Generally, these include hospital, medical, mental health and substance abuse benefits, and prescription drug benefits.

HESC's policy regarding retiree healthcare benefits is to pay the amounts billed through the State's fringe benefit rate on a pay-as-you-go basis. HESC has no obligation beyond the payment of the State's fringe benefit rate for retiree healthcare benefits. The State's policy is that the State is responsible for recording the annual required contribution and the actuarial accrued liability under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits, Other Than Pensions*, for HESC's retiree health care benefits in the State's governmental-wide financial statements.

As of March 31, 2017 and 2016, HESC had approximately 518 and 506 retired and/or spouses of retired employees receiving retiree health care benefits with an annual pay-as-you-go cost of approximately $5.3 million and $4.9 million, respectively.

(10) Employees Vacation Pay Benefit

Under the terms of HESC management's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a combined maximum of 30 days. The Operating Fund recognizes employees' vacation pay benefits when earned. The liability for employees' vacation pay benefits is $1,111,768 and $907,861 as of March 31, 2017 and 2016, respectively, and is recorded in accounts payable and accrued expenses in the Operating Fund.

(11) Deferred Compensation

The State offers its employees, including HESC employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are placed in trust for participants and their beneficiaries.

(12) Leases

HESC leases office and storage space under noncancelable operating leases effective through March 31, 2018. HESC's lease of office space expired in July 2017, but will continue to rent existing space on a month-to-month basis lease agreement until the State's Office for General Services negotiates a new lease for HESC. Total rental expense recorded in the Operating Fund, which includes utilities for HESC's one significant lease, for the years ended March 31, 2017 and 2016, was $1,488,429 and $1,527,694, respectively. The following is a summary of total future minimum rental commitments under noncancelable leases with terms exceeding one year:

Year ending March 31, 2018	$	537,961

(13) Contingencies

The Operating Fund and the Federal Fund are subject to U.S. Department of Education oversight and audit that at times may result in program issues and potential liabilities. The issues relate to possible violations of the rules and regulations established by the U.S. Department of Education to administer the federal loan programs. Management diligently attempts to interpret the FFELP rules and regulations, and believes that its implementation of policies and procedures properly adheres to those rules and regulations, and that any resulting liabilities would not be material.

During the normal course of business the Guaranteed Student Loan Programs are involved in various legal proceedings and investigations, pertaining to matters relating to the Programs' operations and activities. While these proceedings and investigations may lead to a possible liability, in the opinion of HESC management, after considering all relevant facts, these possible liabilities will not in the aggregate have a material adverse effect on the financial position of the Operating Fund or Federal Fund as of March 31, 2017 and 2016, respectively.

As of the financial statement issuance date, HESC was working to verify the collections process performed in relation to certain classes of student loans purchased by the agency. There is the potential for a liability resulting from the activities being performed that cannot reasonably be determined at this time. Management believes, however, that the resolution of the verification and any resulting liability will not likely materially affect the financial position or operations of HESC.

HESC is exposed to various risks of loss related to damage and destruction of assets, injuries to employees, or noncompliance with Federal requirements and other natural and other unforeseen disasters. HESC in general does not insure its buildings, contents or related risks and does not insure its assets for claims and assessments arising from bodily injury, property damages, and other perils. Unfavorable judgments, claims, or losses incurred by HESC are covered by the State on a self-insured basis. The State does have fidelity insurance on State employees.

THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

(A Component Unit of the State of New York)

Required Supplementary Information

Schedule of Employer Contributions – New York State and Local Employees' Retirement System Pension Plan (Unaudited)

March 31, 2017

		2017	**2016**
Contractually determined contribution	$	1,669,723	2,007,242
Contributions in relation to the contractually required contribution		2,096,423	2,263,283
Contribution deficiency (excess)	$	(426,700)	(256,041)
Covered payroll	$	14,190,287	15,157,162
Contributions as a percentage of covered payroll		11.77%	13.24%

Note: This schedule is intended to show information for ten years. Additional years will be displayed as they become available.

Schedule of Proportionate Share of the Net Pension Liability – New York State and Local Employees' Retirement System Pension Plan (Unaudited)

March 31, 2017

		2017	**2016**
HESC's proportionate share of the net pension liability		0.044732%	0.04882%
HESC's proportionate share of the net pension liability	$	7,179,512	1,649,233
Covered payroll	$	15,157,162	16,259,949
HESC's proportionate share of the net pension liability as a percentage of its covered payroll		47.37%	10.14%
Plan fiduciary net position as a percentage of the total pension liability		90.7%	97.9%

The 2017 pension information is based on an actuarial date of April 1, 2015 using a measurement date of March 31, 2016.

The 2016 pension information is based on an actuarial date of April 1, 2014 using a measurement date of March 31, 2015.

Note: This schedule is intended to show information for ten years. Additional years will be displayed as they become available.

See accompanying independent auditors' report.