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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, 2018 and 2017

(With Independent Auditors' Report Thereon)

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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, 2018 and 2017, and the related notes to the financial statements, which collectively comprise HESC's basic financial statements for the years then ended, as listed in the table of contents.

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, 2018 and 2017, and the respective changes in net position, and cash flows thereof for the years 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 Governmental Accounting Standards Board (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 audits 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 26, 2018 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 26, 2018

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, 2018 and 2017. 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.

2018 Financial Highlights – Operating Fund

- Current assets increased by $2.6 million or 4%.
- Current liabilities increased by $0.1 million or 1%.
- Total operating revenue decreased by $12.8 million or 16%.
- Total operating expenses decreased by $12.3 million or 22%.
- The Operating Fund provided approximately $19.0 million for the cost of administering the New York State grant and scholarship programs, which is an increase of $2.6 million or 16% from the prior year.
- 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), which is an increase of $0.2 million or 33% from the prior year.

- The Operating Fund provided approximately $1.2 million for the cost of administering the Mentor Program, the College Choice Program and NY HELPs Program for New York State, which is an increase of $0.4 million or 50% from the prior year.

2018 Financial Highlights – Federal Fund

- Current assets increased by $9.5 million or 14%.
- Total operating revenue decreased by $80.8 million or 13%, as a result of a decline in default claims submitted for reimbursement.
- Total operating expenses decreased by $75.8 million or 12%, as a result of a decline in default claims paid lenders consistent with operating revenues.

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%.
- Total 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.

Condensed Financial Information

Dollar in thousands

		Operating fund			Federal fund		
		2018	**2017**	**2016**	**2018**	**2017**	**2016**
Current assets	$	76,828	74,180	70,030	76,034	66,562	51,935
Capital assets		40	—	10	—	—	—
Other noncurrent assets		—	—	—	1,745	1,606	2,256
Total assets	$	76,868	74,180	70,040	77,779	68,168	54,191
Deferred outflows of resources	$	4,529	8,296	2,993	—	—	—
Current liabilities	$	12,663	12,554	14,147	833	461	585
Noncurrent liabilities		7,602	10,946	6,356	—	—	—
Total liabilities	$	20,265	23,500	20,503	833	461	585
Deferred inflows of resources	$	655	876	—	—	—	—
Net position:							
Invested in capital assets	$	40	—	10	—	—	—
Restricted		60,437	58,100	52,520	76,946	67,707	53,606
Total net position	$	60,477	58,100	52,530	76,946	67,707	53,606
Operating revenues:							
Defaulted loan collections	$	58,111	70,225	70,093	225,640	278,672	263,142
Reimbursement of defaulted loans		—	—	—	328,128	356,255	385,761
Other operating revenues		8,056	8,700	8,978	588	260	783
Nonoperating revenues		5,883	4,505	8,343	392	197	58
Total revenues	$	72,050	83,430	87,414	554,748	635,384	649,744
Operating expenses:							
Administrative		41,857	54,684	51,868	—	—	—
Default loan purchases		—	—	—	327,424	355,249	394,742
Collection payments to ED		—	—	—	218,080	266,027	250,470
Other		1,536	1,055	1,107	5	6	13
Nonoperating expenses		26,280	22,121	36,148	—	—	—
Total expenses	$	69,673	77,860	89,123	545,509	621,282	645,225
Increase (decrease) in net position	$	2,377	5,570	(1,709)	9,239	14,102	4,519

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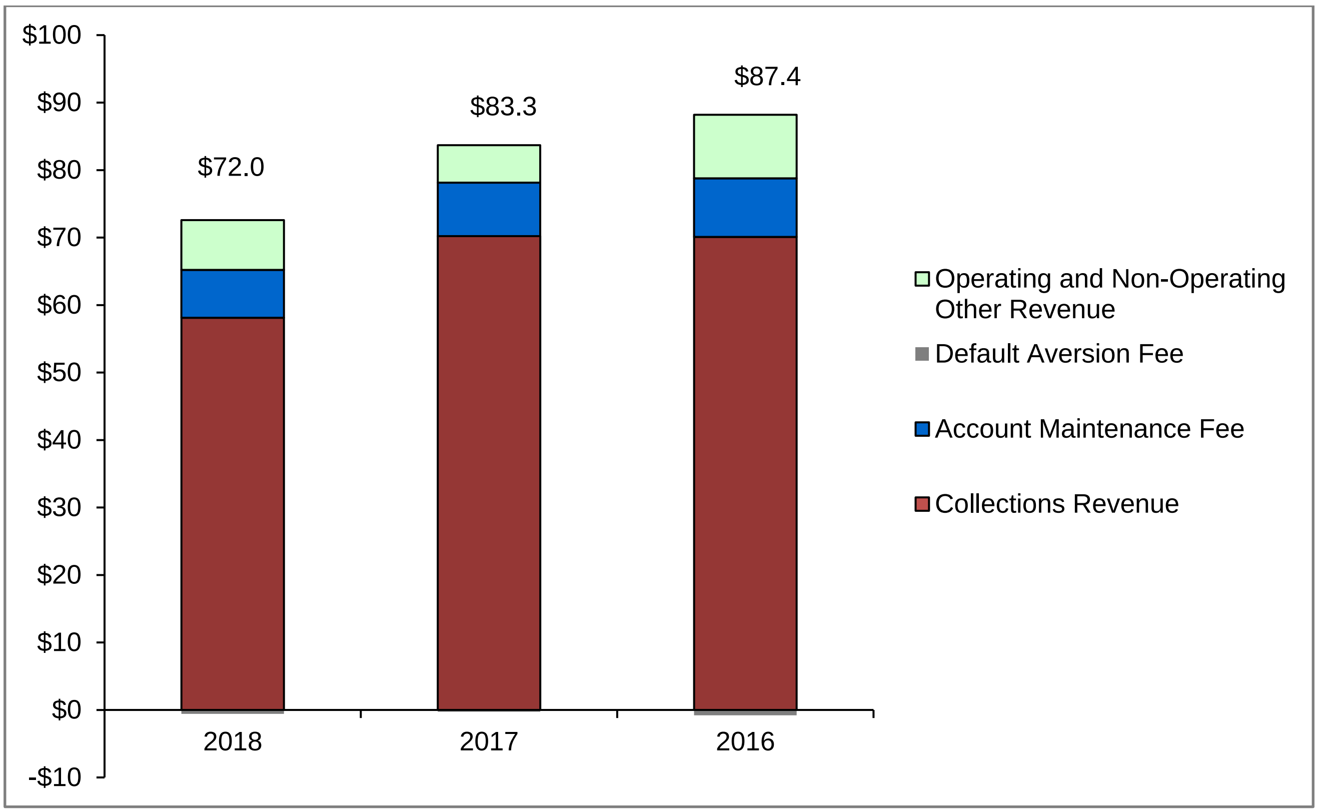
Total Operating Fund Revenue

(Dollar in millions)



Operating Fund Revenue Highlights for fiscal year ending March 31

2018	2017
• Collections revenue decreased from the prior year consistent with the wind down of the FFEL program. Collections revenue represents 81% of total revenue, which decreased 3% from the prior year. • Account maintenance fee income decreased by $0.8 million, consistent with prior year, 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 $0.1 million resulting in $0.5 million expense due back to the Federal Fund as a result of DAF refunds exceeding the DAF revenue for the year. • Other revenue includes $1.5 million in Treasury offset refunds revenue which is 100% offset by the expense of payments to borrowers in 2017-2018 and increased $0.5 million from the prior year. • Non-operating federal grant revenue increased $1.0 million from the prior year to $5.3 million, all of which is passed through to grant subrecipients.	• 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 $1.0 million in Treasury offset refunds revenue which is 100% offset by the expense of payments to borrowers in 2016-2017. • Non-operating federal grant revenue decreased $3.9 million to $4.3 million as a result of decreases in funding and expenditures related to the College access Challenge Grant Program (CACG) as the program winds down.

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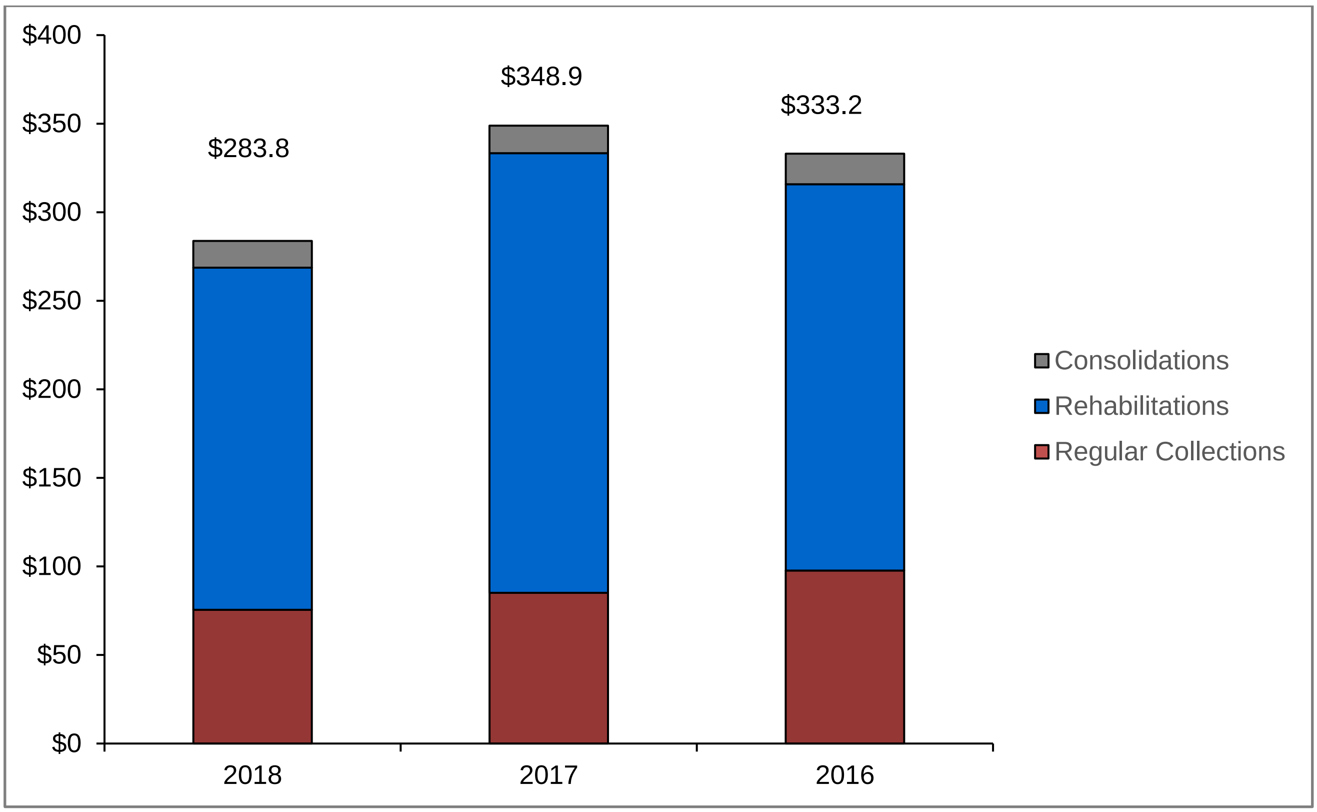
Total Default Collection Recoveries – Operating and Federal Fund

(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

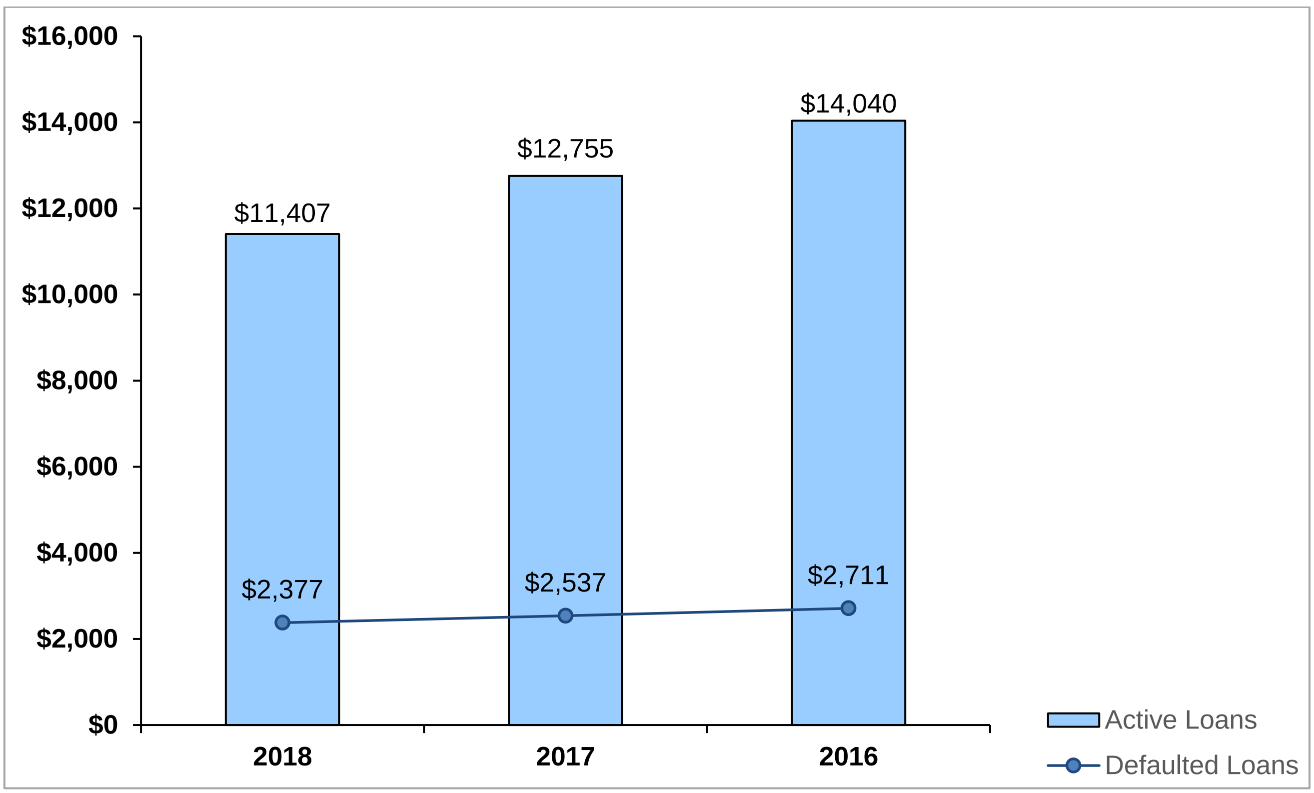
2018	2017
• Collections on rehabilitated loans decreased \$55 million or 22% to \$193 million in 2017-2018 from a total of \$248 million in 2016-2017. • Total regular collections decreased \$10 million or 11% from \$85 million in 2017 to \$75 million in 2018. All sources of regular collection recoveries decreased in 2018 as a result of a 6% decrease in the collectible default portfolio. • Federal direct default consolidation revenue decreased 3% in 2018 to \$16 million from \$15 million in 2017.	• 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.

HESC implemented a new collection strategy during 2017-2018 whereby defaulted accounts are held for collections for 120 days, previously 60 days, before referral to an outside collection agency. The change decreased rehabilitation and consolidation revenue for a period of time within the state fiscal year 2017-2018. The declining collectible default portfolio will continue to affect HESC's recoveries.

Operating Fund Administration Revenue on Guaranteed FFEL Loans

Outstanding Portfolio Balances

(Dollar in millions)



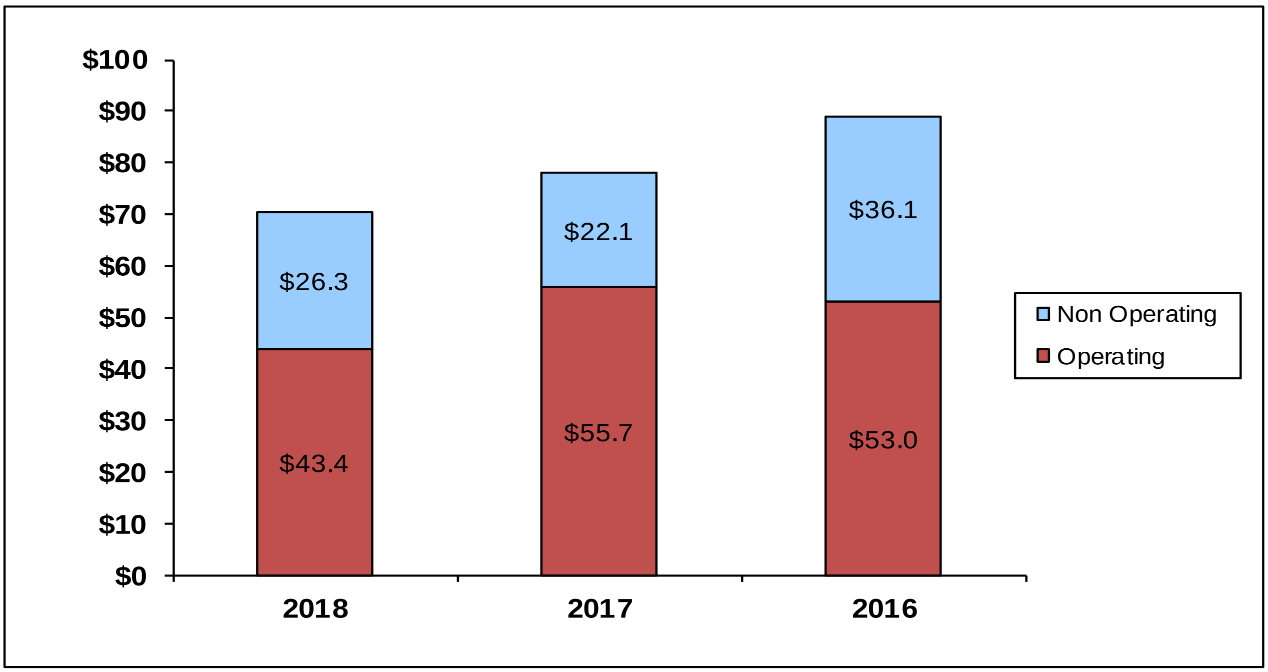
Administrative Revenue Highlights for the fiscal year ending March 31

2018	2017
• HESC's outstanding active portfolio balance decreased by $1.3 billion or 10% 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 consistent with prior years. • HESC's outstanding default portfolio decreased $0.2 billion during the fiscal year as a result of the aging portfolio consistent with prior years.	• 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.

(Continued)

Total Operating Fund Expenses

(Dollar in millions)



Operating Expense Highlights for fiscal year ending March 31

2018

Operating Expenses

- Outsourced vendor collection fees decreased $5.8 million or 22% due to a change in HESC collection strategy which includes holding accounts at HESC longer, resulting in a decrease in all types of vendor collection recoveries.
- Payroll and fringe benefit expense decreased by $1.2 million or 8%. The decrease in personal service is due to decreased full time equivalents from 198 in 2017 to 182 in 2018, offset by an increase in union salary rates.
- NYS Servicing and ITS data center expense decreased $4.5 million or 62% from $7.5 million in 2016-2017 to $3.0 million in 2017-2018 as a result of a change in the allocation percentage between FFELP and Grants and Scholarships for application services based on detail Time Distribution System (TDS) reports.
- Other expense includes $1.5 million of Treasury offset refunds sent to borrowers which is 100% reimbursed by the Federal Department of Education.

2017

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.

(Continued)

2018

Nonoperating Expenses

- Grant and scholarship program expense increased $2.4 million in 2017-2018. NYS Servicing costs increased $3.1 million primarily due to an updated cost allocation based upon TDS reporting for application services. In addition, personal service and fringe benefits decreased $0.7 million as a result of a decrease in FTE's during 2017-2018.
- The New York State Mentoring Program creates supportive mentor relationships for students at risk of dropping out of school. Costs for 2017-2018 were $1.1 million, an increase of $0.1 million from the prior year.
- Federal grant expense of $6.1 million includes $5.3 million in payments to grantees which are 100% reimbursed by the Federal Grant. HESC paid administrative expenses of $0.8 million in 2017-2018. Federal grant payments to sub-recipients increased approximately $1 million in 2017-2018.

2017

Nonoperating Expenses

- 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 Mentoring 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.

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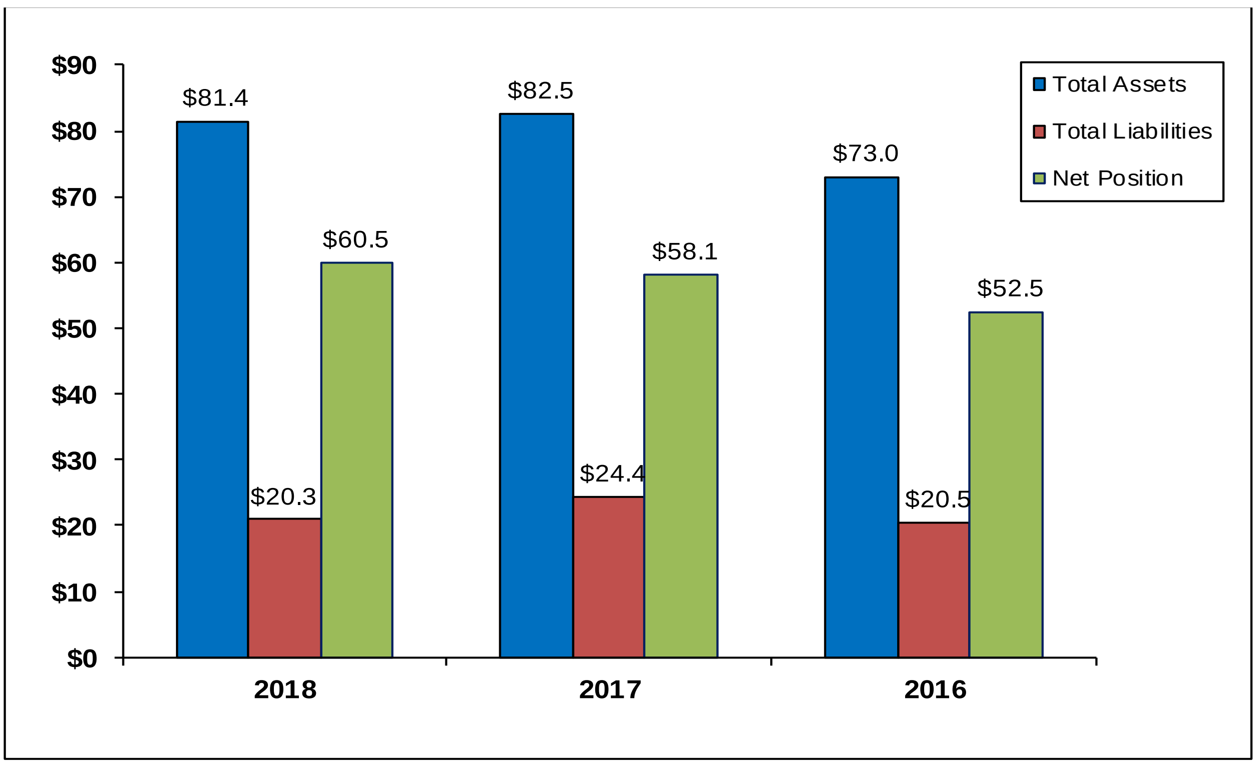
Operating Fund Assets and Liabilities

(Dollar in millions)



2018

Assets

- Total operating fund assets are primarily current assets, consisting of cash and cash equivalents and receivables due from the U.S. Department of Education and the Federal Fund.
- Total assets decreased $1.1 million or 1% in 2017-2018, primarily due to an increase in cash from operational activities of $22.7 million, partially offset by the cash out flow from noncapital financial activities of $20.9 million.

Liabilities

- Accounts payable and accrued liabilities represented 63% and 53% of total liabilities for the state fiscal years 2017-2018 and 2016-2017, respectively.
- Noncurrent liabilities decreased $3.3 million, as a result of decreased pension liability.

Deferred Outflows of Resources

- Deferred outflows of resources for payments related to pensions subsequent to the associated measurement date decreased $3.8 million in 2017-2018.

Net Position

- Net position increased $1.7 million or 3% due to net operating income exceeding net nonoperating expenses.

2017

Assets

- Total assets in the Operating Fund increased $4.1 million from 2015-2016 to 2016-2017 or 5.9% as a result of total revenue exceeding expenses in 2016-2017.

Liabilities

- Total liabilities increased $3.0 million of 14.6% in 2016-2017 as a result of an increase in the net pension liability of $5.2 million or 127%, partially offset by a decrease in accounts payable of $1.6 million or 11.3%. In addition, interfund default aversion fee payable decreased $0.6 million from 2015-2016 as a result of decreased aversion revenue.

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.

Net Position

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

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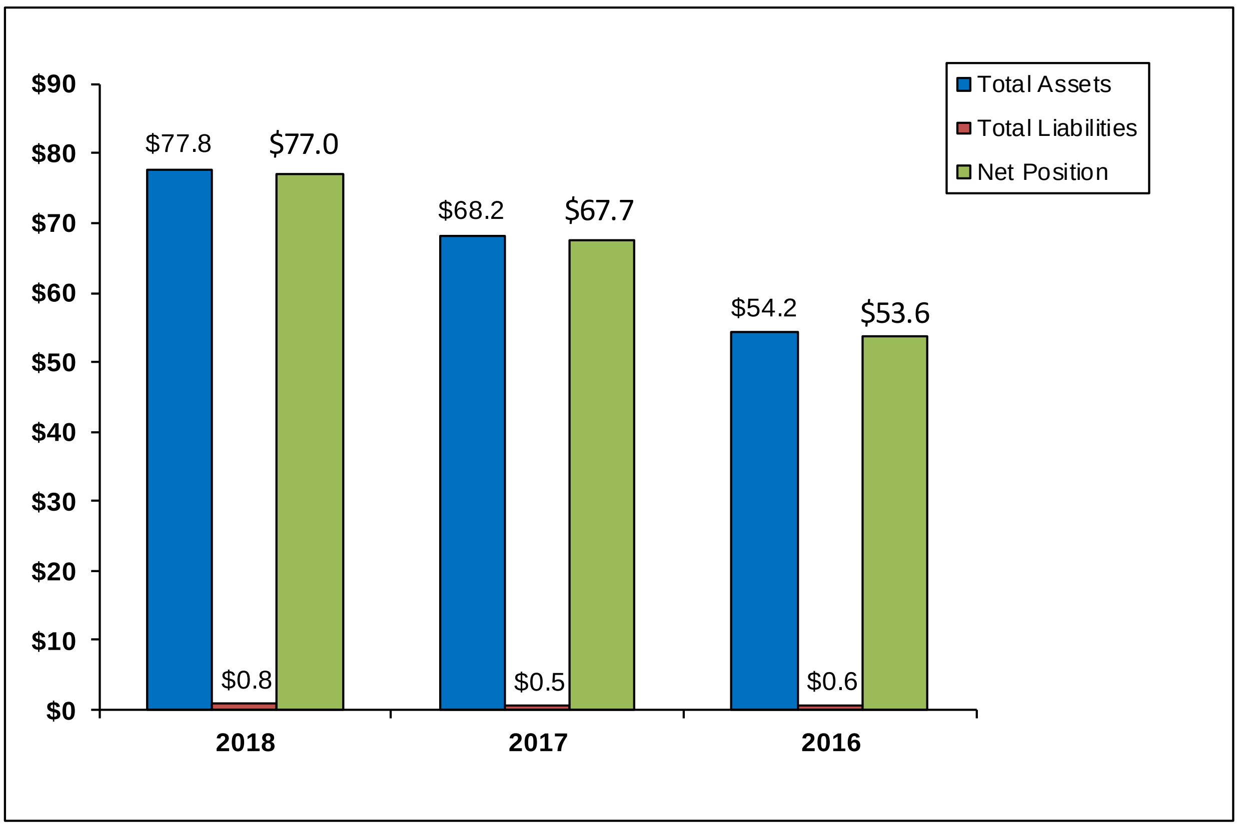
The Federal Student Loan Reserve Fund (Federal Fund)

(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.

2018	2017
Assets • Cash and cash equivalents increased $19.1 million in 2017-2018 as a result of $9.2 million in net income from operations and a reduction in the federal reinsurance receivable of $9.6 million. • Noncurrent assets decreased $0.1 million as a result of decreased default aversion fee revenue and estimated future returns. **Liabilities** • HESC current liabilities for the fiscal year 2017-2018 represent amounts due to Operating Fund for default collections and aversion fees. **Net Position** • Net position increased $9.2 million or 14% in 2017-2018 as a result of higher reinsurance reimbursement rates on default purchases.	**Assets** • The Federal Fund cash and cash equivalents decreased $7.7 million or 15% in fiscal 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 receivable from U.S. Department of Education in the amount of $22.5 million and a decrease in cash and cash equivalents of $7.7 million. **Liabilities** • HESC liabilities represent amounts due to the Operating Fund for default collections and aversion fees which increased over the prior year but remained under $1.0 million in 2016-2017. **Net Position** • Net position increased $14.1 million or 26% in 2016-2017 as a result of a decrease in default purchases from lenders 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 $19 million for state fiscal year ended March 31, 2019.

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, 2018 and 2017

		2018		2017	
Assets and Deferred Outflows of Resources		**Operating fund**	**Federal fund**	**Operating fund**	**Federal fund**
Current assets:					
Cash and cash equivalents (note 4)	$	73,679,270	63,302,399	71,304,308	44,190,768
Receivables due from U.S. Department of Education:					
Administrative fees (note 5)		1,702,121	—	1,901,881	—
Reinsurance		—	12,731,991	—	22,340,007
Interfund balances (note 6)		829,855	—	460,420	—
Prepaid expenses and other assets		185,688	—	279,355	30,817
Due from Federal Government		430,802	7	234,254	—
Total current assets		76,827,736	76,034,397	74,180,218	66,561,592
Noncurrent assets:					
Interfund default aversion fee allowance (note 5)		—	1,745,080	—	1,606,064
Capital assets, net		39,706	—	—	—
Total noncurrent assets		39,706	1,745,080	—	1,606,064
Total assets		76,867,442	77,779,477	74,180,218	68,167,656
Deferred outflows of resources related to pensions (note 8)		4,529,370	—	8,295,734	—
Total assets and deferred outflows of resources	$	81,396,812	77,779,477	82,475,952	68,167,656
Liabilities, Deferred Inflows of Resources and Net Position					
Current liabilities:					
Accounts payable and accrued liabilities	$	12,629,861	3,086	12,528,544	—
Interfund balances (note 6)		—	829,855	—	460,420
Amounts payable to schools		32,796	—	25,513	—
Total current liabilities		12,662,657	832,941	12,554,057	460,420
Noncurrent liabilities:					
Pension contributions payable (note 8)		1,883,716	—	2,160,376	—
Net pension liability (note 8)		3,972,815	—	7,179,512	—
Interfund default aversion fee allowance (note 5)		1,745,080	—	1,606,064	—
Total noncurrent liabilities		7,601,611	—	10,945,952	—
Total liabilities		20,264,268	832,941	23,500,009	460,420
Deferred inflows of resources related to pensions (note 8)		654,973	—	875,744	—
Total liabilities and deferred inflows of resources		20,919,241	832,941	24,375,753	460,420
Net position:					
Invested in capital assets		39,706	—	—	—
Restricted – note 2 c		60,437,865	76,946,536	58,100,199	67,707,236
Total net position		60,477,571	76,946,536	58,100,199	67,707,236
Total liabilities, deferred inflows of resources and net position	$	81,396,812	77,779,477	82,475,952	68,167,656

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, 2018 and 2017

	2018		2017	
	Operating fund	**Federal fund**	**Operating fund**	**Federal fund**
Operating revenues:				
Defaulted loan collections (note 2(e))	$ 58,111,109	225,640,523	70,225,406	278,672,059
Administrative and program fee income (note 5)	6,517,526	—	7,649,590	—
Reimbursement on purchases of default loans from lenders (note 2(f))	—	328,127,876	—	356,254,918
Default aversion fee subsidy	—	587,819	—	259,655
Other revenue	1,538,278	—	1,049,887	6
Total operating revenues	66,166,913	554,356,218	78,924,883	635,186,638
Operating expenses:				
Salaries and employee benefits	14,906,303	—	16,088,965	—
General and administrative	3,851,732	—	5,335,361	—
Collection vendors	20,076,221	—	25,820,487	—
NYS servicing	1,755,099	—	6,066,929	—
NYS Information Technology Services infrastructure	1,267,629	—	1,372,381	—
Purchases of default loans from lenders (note 2(f))	—	327,423,784	—	355,249,156
Defaulted loan collections paid to U.S. Department of Education (note 2(e))	—	218,079,650	—	266,027,098
Depreciation	7,941	—	10,001	—
Other expense	1,527,596	5,144	1,045,624	5,532
Total operating expenses	43,392,521	545,508,578	55,739,748	621,281,786
Operating income	22,774,392	8,847,640	23,185,135	13,904,852
Nonoperating revenues (expenses):				
Interest income	556,747	391,660	169,451	196,614
Federal grant revenue	5,326,686	—	4,335,910	—
Federal grant administrative expenses	(6,125,351)	—	(4,944,383)	—
New York State initiatives (note 7)	(20,155,102)	—	(17,176,329)	—
Total nonoperating (expenses) revenues	(20,397,020)	391,660	(17,615,351)	196,614
Increase in net assets	2,377,372	9,239,300	5,569,784	14,101,466
Net position, beginning	58,100,199	67,707,236	52,530,415	53,605,770
Net position, ending	$ 60,477,571	76,946,536	58,100,199	67,707,236

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, 2018 and 2017

	2018		2017	
	Operating fund	Federal fund	Operating fund	Federal fund
Cash flows from operating activities:				
Receipts from:				
Collections	$ 57,826,362	226,057,880	69,780,772	278,686,997
Administrative fees	6,904,224	—	7,131,168	—
Other sources	1,538,278	—	1,049,887	—
Reimbursement on purchases of default loan purchases	—	346,436,294	—	342,397,669
Federal default aversion fee income	—	400,883	—	973,738
Payments for:				
Salaries and employee benefits	(18,114,809)	—	(11,270,966)	—
Purchases of default loans from lenders	—	(336,106,961)	—	(363,932,333)
Collections paid to U.S. Department of Education	—	(218,093,798)	—	(266,030,966)
General, administrative and other expenses	(25,424,704)	(5,145)	(43,771,917)	(5,526)
Net cash provided by (used in) operating activities	22,729,351	18,689,153	22,918,944	(7,910,421)
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(20,863,490)	—	(17,288,538)	—
Net cash used in noncapital financing activities	(20,863,490)	—	(17,288,538)	—
Purchases of capital assets	(47,647)	—	—	—
Net cash used in capital financing activities	(47,647)	—	—	—
Cash flows from investing activities:				
Interest received	556,748	422,478	169,892	166,134
Net cash provided by investing activities	556,748	422,478	169,892	166,134
Increase (decrease) in cash and cash equivalents	2,374,962	19,111,631	5,800,298	(7,744,287)
Cash and cash equivalents, beginning	71,304,308	44,190,768	65,504,010	51,935,055
Cash and cash equivalents, ending	$ 73,679,270	63,302,399	71,304,308	44,190,768
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	$ 22,774,392	8,847,640	23,185,135	13,904,852
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation	7,941	—	10,001	—
Change in assets and liabilities that provided (used) cash:				
Receivables from U.S. Department of Education	199,760	9,608,016	195,661	(22,544,205)
Due from Federal Fund	(196,548)	(7)	—	—
Other assets	93,667	—	11,998	—
Interfund balances	(369,435)	369,435	(79,216)	79,216
Accounts payable and accrued liabilities and other liabilities	18,322	3,085	(567,460)	(88)
Allowance for default aversion refunds	139,016	(139,016)	(649,804)	649,804
Net pension liability, net of deferred outflows of resources, deferred inflows of resources, and pension contribution payable	62,236	—	812,629	—
Total adjustments	(45,041)	9,841,513	(266,191)	(21,815,273)
Net cash provided by (used in) operating activities	$ 22,729,351	18,689,153	22,918,944	(7,910,421)

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 (GEAR UP) federal grant which is designed to increase the number of low income students who are prepared to enter and succeed in postsecondary education. This program is included in the accompanying financial statements as nonoperating revenue 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 are liquid assets with original maturities of 90 days or less, consisting of United States Treasury and New York State bonds and notes, which are carried at amortized cost. Investment income represents interest on deposits and the amortization of the discount or premium on cash equivalents.

(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. The Operating Fund retains 16% of borrower payments and rehabilitation collections and 10% of principal and interest at the time of consolidation.

(Continued)

(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 2018, HESC was processing claims for 8 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 certain accrued expenses. Actual results could differ from those estimates.

(3) Guaranteed Loans Outstanding and Respective Unpaid Balances

As of March 31, 2018 and 2017, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately $11,427,000,000 and $12,755,000,000, 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, 2018 and 2017, the unpaid balances were approximately $8,562,000,000 and $9,663,000,000, 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 noninterest earning funds. Cash balances in an administrative account in the Operating Fund and Federal Fund are invested in the New York State Comptroller's short-term investment pool and are recorded at amortized cost. 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. 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 Statement No. 72, *Fair Value Measurement and Application* (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, 2018 and 2017.

Cash and cash equivalents at March 31 were as follows:

		2018	2017
Operating Fund:			
Cash in State Comptroller's short-term investment pool	$	64,020,730	27,758,063
Cash in bank		9,658,540	43,546,245
Total Operating Fund cash and cash equivalents	$	73,679,270	71,304,308
Federal Fund:			
Cash in State Comptroller's short-term investment pool	$	55,172,684	—
Cash in bank		8,129,715	44,190,768
Total Federal Fund cash and cash equivalents	$	63,302,399	44,190,768

(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 $1,745,080 and $1,606,064 at March 31, 2018 and 2017, 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, 2018 and 2017, the administrative fees receivable from U.S. Department of Education consisted of the following:

		2018	2017
Operating Fund:			
Account maintenance fee receivable	$	1,702,121	1,901,881

For the years ended March 31, 2018 and 2017, administrative fee income is as follows:

		2018	2017
Operating Fund:			
Default aversion fee subsidy, net of estimated refunds	$	(587,819)	(259,655)
Account maintenance fee		7,105,345	7,909,245
Total administrative and program fee income	$	6,517,526	7,649,590

Gross default aversion fee income for the years ended March 31, 2018 and 2017 was $1,117,523 and $1,203,704, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2018 and 2017, the default aversion fee allowance estimate was 130% and 110% of default aversion fee income or $1,705,343 and $1,463,359, respectively. The estimate of the refunds is based on the four 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 to each fund 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, 2018, the Operating Fund had a net interfund receivable balance of $829,855 consisting of a receivable from the Federal Fund for overpayment of collections for the month of $909,448 and an interfund default aversion payable of $79,593. At March 31, 2017, the interfund receivable consisted of an overpayment of collections activity of $492,091 due to the Operating Fund and a default aversion fee payable to the Federal Fund of $31,671.

(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 $18,994,592 and $16,352,326 in the years ended March 31, 2018 and 2017, respectively.

In the years ended March 31, 2018 and 2017, HESC's Operating Fund incurred costs of $117,950 and $69,836, 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, 2018 and 2017 in the amounts of $14,540 and $31,319, 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, 2018 and 2017 of $1,028,020 and $722,848, respectively.

The activities of these State programs are included in the accompanying financial statements as nonoperating 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.

Permanent cost-of-living adjustment (COLA) benefits for both current and future and future retired members are provided in Section 532-a of the Education Law. This benefit will be paid commencing September of each year to retired members who have attained age 62 and have been retired for five years or who have attained age 55 and have been retired for 10 years. Disability retirees must have been retired for five years, regardless of age, to be eligible. The annual COLA percentage is equal to 50 percent of the increase in the consumer price index, not to exceed 3 percent nor be lower than 1 percent. It is applied to the first $18,000 of the annual benefit.

(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, 2018 and 2017 was 18.79% and 16.47%, respectively, of covered payroll.

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, 2018 of $2,160,376, of which $1,883,716 is in noncurrent liabilities and $276,660 is included in current liabilities. As of March 31, 2017, the pension contribution payable attributable to HESC was $2,447,984, of which $2,160,376 was in noncurrent liabilities and $287,608 was included in current liabilities.

(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 was $3,972,815 at March 31, 2018. The liability was measured as of March 31, 2017, using an actuarial valuation as of April 1, 2016, with update procedures used to roll forward the total pension liability to March 31, 2017. HESC's proportionate share of the State's collective net pension liability was $7,179,512 at March 31, 2017. The liability was measured as of March 31, 2016, using an actuarial valuation as of April 1, 2015, with update procedures used to rollforward the total pension liability to March 31, 2016. 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, 2017, HESC's proportion of the net pension liability of the New York State Employees' Retirement System (ERS) was 0.04228%, compared to 0.04473% at March 31, 2016.

For the year ended March 31, 2018, HESC recognized a pension expense of $2,565,299. At March 31, 2018, HESC reported the following deferred outflows and deferred inflows of resources related to pension from the following sources:

		Deferred outflows of resources	Deferred inflows of resources
Difference between expected and actual experience	$	99,555	603,294
Net difference between projected and actual investment earnings on pension plan investments		793,532	—
Changes in proportion and differences between contributions and proportionate share of contributions		52,621	51,679
Changes of assumptions		1,357,259	—
Contributions made subsequent to measurement date		2,226,403	—
Total	$	4,529,370	654,973

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 and deferred inflows 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

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, 2019. The remaining cumulative net amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in future pension expense as follows:

Year ending March 31:		
2019	$	755,950
2020		755,950
2021		672,378
2022		(536,284)

(e) Actuarial Assumptions

The total pension liability at the measurement date of March 31, 2017 was determined by using an actuarial valuation as of April 1, 2016, with update procedures used to roll forward the total pension liability to March 31, 2017. The total pension liability for the March 31, 2016 measurement date 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 used in the actuarial valuations were as follows:

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 the Plan's 2015 experience study for period April 1, 2010 through March 31, 2015
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, 2016 and 2015 are summarized below:

Asset class	Target allocation	Long-term expected real rate of return
Domestic equity	36 %	4.55 %
International equity	14	6.35
Private equity	10	7.75
Real estate	10	5.80
Absolute return strategies	2	4.00
Opportunistic portfolio	3	5.89
Real assets	3	5.54
Bonds and mortgages	17	1.31
Cash	1	(0.25)
Inflation indexed bonds	4	1.50
	100 %	

The real rate of return is net of the long-term inflation assumption of 2.50%.

(ii) Discount Rate

The discount rate used to calculate the total pension liability was 7.0% for the March 31, 2017 and March 31, 2016 measurement dates. 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.

The following presents the net pension liability of HESC calculated using the 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%)
2018	$	12,688,381	3,972,815	(3,396,181)
2017	$	16,189,276	7,179,152	(433,355)

(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 a single employer defined benefit plan and financial information is reported in an agency fund and accounted for on the accrual basis of accounting. 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, 2018, 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.

(Continued)

As of March 31, 2018 and 2017, HESC had approximately 536 and 518 retired and/or spouses of retired employees receiving retiree health care benefits with an annual pay-as-you-go cost of approximately $5.7 million and $5.3 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 $1,319,163 and $1,111,768 as of March 31, 2018 and 2017, 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, 2018 and 2017, was $1,248,086 and $1,488,429, respectively.

(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, 2018 and 2017, 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, 2018

		2018	2017	2016
Contractually determined contribution	$	1,601,962	1,669,723	2,007,242
Contributions in relation to the contractually required contribution		2,553,882	2,096,423	2,263,283
Contribution deficiency (excess)	$	(951,920)	(426,700)	(256,041)
Covered payroll	$	13,485,270	14,190,287	15,157,162
Contributions as a percentage of covered payroll		11.88 %	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, 2018

		2018	2017	2016
HESC's proportionate share of the net pension liability		0.042281 %	0.044732 %	0.048820 %
HESC's proportionate share of the net pension liability	$	3,972,815	7,179,512	1,649,233
Covered payroll	$	14,190,287	15,157,162	16,259,949
HESC's proportionate share of the net pension liability as a percentage of its covered payroll		28.00 %	47.37 %	10.14 %
Plan fiduciary net position as a percentage of the total pension liability		94.7 %	90.7 %	97.9 %

The 2018 pension information is based on an actuarial date of April 1, 2016 using a measurement date of March 31, 2017.

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.