THE STATE of ALASKA
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Agenda Item 6

Memorandum

To:	Alaska Student Loan Corporation Members
Thru:	Diane Barrans, Executive Officer
From:	Charlene Morrison, Chief Finance Officer
Date:	April 27, 2015
Re:	Semi-annual Financial Report

The Alaska Student Loan Corporation's (Corporation) semi-annual financial report, for the periods ended December 31, 2014 and 2013, has been finalized and accompanies this memorandum. Following are highlights and other items management wanted to bring to the attention of board members.

The semi-annual report represents balances and results of operations for the six-month periods ended December 31. Other than the lack of the Management's Discussion and Analysis section, the report has been prepared in accordance with generally accepted accounting principles. This report is a required communication under the Corporation's 2012 and 2013 Trust Indentures. Page five reflects the Corporation's change in net position (net income) of $1,382,000 and $4,142,000 for the periods ended December 31, 2014 and 2013, respectively.

Net income is the difference between revenue and expense for the period. As reflected in the past several financial reports, operating revenue continues to decline. Operating revenue consists of interest on education loans and earnings on investments. Both the loan (see footnote 4 on page 22) and investment (see footnote 3(b) on page 11) portfolios are declining; therefore, income earned on them is declining.

> The net education loan portfolio decreased 15% in calendar year 2014. Interest income for the first six months of fiscal year 2015 was 14% lower than interest income for the same period in fiscal year 2014. There has been no significant change in the annualized loan yield between periods; therefore, the change in loan income is attributed to the decrease in the portfolio.
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> Average invested assets decreased almost 10% in calendar year 2014. The average return on investments for the first six months of fiscal years 2015 and 2014 was 0.13% and 0.42%, respectively. The decrease in investment income is attributed to both the declining portfolio balance as well as the lower return on invested assets.
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> Operating expense increased approximately $1 million due to a higher loan loss provision for the period ended December 31, 2014 compared to the same period in the year earlier. The provision represents the current period change in estimated loan principal losses and

interest losses on that principal. The provision is based on past experience and is adjusted upward or downward over time as historical loan performance changes. The provision related to principal loan losses increased almost $1.9 million and the interest loss provision increased approximately $459,000 in the first six months of fiscal 2015. Interest continues to accrue on doubtful loans until they are written off or until the borrower begins to make payments resulting in the loan being removed from the doubtful category.

Changes in other operating expense categories are as follows:

Interest expense has declined due to the declining balance in outstanding debt. The average rate on outstanding debt did not change significantly between the periods presented.

Administrative costs declined due to one-time purchases made in early fiscal 2014 for office reconfiguration, grant system maintenance being funded by the Higher Education Investment Fund instead of the Corporation and various timing differences between periods presented.

Non-operating revenue consists of federal direct loan servicing fees. This revenue is declining due to the reduction in the federal direct loan portfolio allocated to the Corporation for servicing. This reduction is expected to continue as additional federal direct loans are not being allocated to not-for-profit servicers.

Non-operating expense has been eliminated due to the final payment being made on bonds issued by the Corporation to fund State capital projects.

The Net Position statement (balance sheet) reflecting asset and liability balances are on pages three and four, respectively. The Corporation's balance sheet consists primarily of investment, loan and debt balances. Page 16 reflects investments held by the Corporation on December 31, 2014 and 2013, respectively. Invested assets are declining for several reasons the most significant of which is debt service payments, loan originations and FFELP excess interest payments being made. Pages 22 and 23 reflect loan balances on December 31, 2014 and 2013, respectively. As expected, the loan portfolio is continuing its decline because new originations are lower than principal payments on existing loans. The summary of debt balances on page 25 reflects the declining debt balance. The Corporation has not incurred new debt since fiscal 2010 and makes scheduled payments on existing debt. The first table on page 26 reflects management's expectation that current debt will be paid-in-full by the end of calendar year 2019.

Net position at the bottom of page four is the difference between assets and liabilities (equity). Unrestricted net position typically declines but the Corporation experienced an increase in this balance during the six-month period ended December 31, 2014. This increase, and the resulting decrease in restricted net position, was the result of loans being released from the 2005 Trust when the final bond payment was made in July 2014. Restricted net assets are not available to the Corporation for any purpose other than those specifically allowed in the trust documents.

Last but not least, I bring your attention to footnote 9(a) on page 28. This footnote has changed little from last year. As discussed at the last several board meetings, in January 2013 the IRS placed the Corporation's tax-exempt education loan revenue bonds under examination. The last written communication from the IRS to the Corporation was a letter dated July 11, 2013 indicating that the tax-exempt bonds were in violation of tax law. The letter did not contain any detail regarding the legal basis for that determination of violation, but we understand from verbal comments made by the IRS agent to the Corporation's outside counsel that the issue is with principal and interest payments on loans made with bond proceeds being recycled into new loans (recycled loans) and the process by which the recycled loan pool is allocated to bond issues for yield restriction calculation purposes. On July 31, 2013 the Corporation responded to the IRS with a letter citing the applicable tax regulation authorizing the allocation method used by the Corporation and requesting the IRS withdraw their conclusion. Management worked with bond counsel and its rebate consultant in drafting this response. The Corporation anticipates receiving a formal letter from the IRS citing the applicable tax regulations supporting their assertion of the Corporation's non-compliance. Once that letter is in hand, the Corporation will work with bond counsel to determine next steps.

If you have any questions or wish to discuss this report, please don't hesitate to give me a call at 907-465-6757 or send a message to Charlene.morrison@alaska.gov.

Thank you