Iowa Superintendent of Banking

Annual Review of the Qualified Student Loan Bond Issuer

Iowa Student Loan Liquidity Corporation (ISLLC)

For the fiscal year July 1, 2016 to June 30, 2017

Introduction

Pursuant to paragraph b, subsection 6, of Iowa Code Section 7C.13, the superintendent of banking is required to annually review the qualified student loan bond issuer's total assets, loan volume, and reserves, and it's procedures to inform students about the advantages of loans available under Title IV of the federal Higher Education Act of 1965, as amended, for which the students may be eligible. The review shall also verify that the qualified student loan bond issuer issued bonds in accordance with Iowa Code Chapter 7C in conformance to the letter requesting approval of the governor as set forth in subsection 5, of Iowa Code Section 7C.13. Examiner Joseph Gordon was appointed by Superintendent Ronald L. Hansen to conduct the review.

Report of Total Assets, Total Liabilities, Loan Volume, Reserves and Affiliates

ISLLC provided audited financial statements dated June 30, 2017 (FY17) which the independent auditors' report noted presented fairly, in all material respects, the financial position of ISLLC as of that date.

As of June 30, 2017, total assets and total deferred outflows of resources* were $1.63 billion, a $21.99 million (1.36%) increase from FY16. Assets consisted primarily of net student loans receivable of $1.30 billion and investments of $241.43 million. Cash and investments increased $106.00 million (76.81%) while net student loans receivable decreased $65.8 million (4.83%) compared to FY16. The decrease in net student loans receivable is primarily due to borrower repayment. New taxable bonds were issued which also provided for the increase in cash.

ISLLC purchased or originated $125.8 million in student loans during FY17 (an increase from $15.3 million in FY16).

Government guaranteed loans made up 42.18% of the student loan portfolio with private loans being the remaining 57.82% at the end of FY17 compared to 46.17% government and 53.83% private at the end of FY16. Federally insured student loans currently carry a 97% guaranty of the principal and interest on loans disbursed after July 1, 2006, while there is no guaranty for private loans.

ISLLC management periodically reviews the student loan portfolio performance and evaluates the probability of losses to determine its allowance for loan loss reserve (ALL). The ALL evaluation on the federally insured loan portfolio is conducted separately from the private loan portfolio. ISLLC considers a private loan to be in a default status when it reaches 120 days delinquent. For defaulted loans, a 100% allowance is applied to the outstanding principal balance for the allowance calculation. A private loan is charged-off when the loan reaches 270 days delinquent without any principal or interest payment activity during the previous 12 months.

ISLLC established a loan loss reserve of 0.15% on the government portfolio ($0.8 million) and 2.30% on the private portfolio ($17.5 million) in FY17. At the end of FY16 the loan loss reserve for government loans was $1.0 million (0.16%) and $21.4 million (2.88%) for private loans.

ISLLC had cash deposits of $2.51 million, which were covered by federal depository insurance or collateralized trust accounts. Investments of $241.43 million included $12.93 million of corporate notes/bonds (A-1+ S&P rating) and $228.50 million of money market mutual funds investing in United States government and agency obligations.

Aspire Resources Inc. (ARI), a discretely presented component unit, had $25.48 million invested in United States agency obligations and $384,050 in money market mutual funds investing in United States government and agency obligations.

Total liabilities increased $45.99 million (4.54%) as compared to FY16 with debt activity making up most of the change. Bond and note maturities totaled $178.4 million and were offset by the issuance of bonds and notes payable totaling $221.6 million resulting in a net debt increase totaling $44.1 million.

Deferred inflows of resources* decreased $27.38 million (29.82%) compared to FY16. The reduction was the result of the accumulated increase in fair value of hedging derivatives reducing from a $6.96 million balance at the end of FY16 to zero in FY17. Refundable origination fees decreased $1.74 million (54.71%) in FY17 compared to FY16 primarily due to normal amortization. Deferred gain on refunded debt activity decreased $18.68 million (22.87%) in FY17 compared to FY 16.

ISLLC's net position (similar to the net worth of a for-profit company) at the end of FY17 was $509.90 million, a $3.38 million (0.67%) increase from FY16.

Total operating revenues for FY17 totaled $65.48 million, a decrease of $2.08 million (3.08%) from FY16. Investment income decreased $2.58 million (56.50%) compared to FY16. Most of this difference is attributable to one-time investment gains ($2.4 million) in FY16 on the release of final funds related to defaulted investments from 2007 that were not repeated during FY17. Investment fair value adjustments improved $1.3 million over the FY16 amount. Student loan interest income increased $0.47 million (0.82%) compared to FY16. ISLLC's average owned outstanding student loan portfolio decreased $95.3 million (5.91%) in FY17. The outstanding balance decline and impacts to student loan interest income was offset by better yields (44 bps). Borrower interest allowance adjustments on defaulted private loans reduced student loan interest income by $4.4 million in FY17.

Total operating expenses for FY17 increased $4.21 million (7.28%) over FY16 totals. Total interest expense on bonds and notes payable during FY17 increased $3.4 million (11.60%) from FY16. The higher cost of debt is considered the primary cause of the increase as average debt outstanding decreased from FY16 to FY17 by $39.5 million (3.53%). Additionally, debt-related expenses increased by $2.97 million in FY17 compared to FY16. Most of this increase relates to additional cost of issuance expense incurred during FY17 compared to FY16 due to new debt. The provision for loan losses, related primarily to private loans, decreased $1.2 million in FY17 when compared to FY16.

With a $509.9 million total net position, loan loss reserves of $18.3 million and an investment policy requiring cash deposits to be back by federal depository insurance or collateralized trust accounts, investments only in U.S. government/agency obligations, highly rated corporate notes and commercial paper, it appears ISLLC has adequately protected the organization's assets from potential future losses.

** The Governmental Accounting Standards Board (GASB) defines deferred outflows of resources as a consumption of net assets that is applicable to a future reporting period and deferred inflows of resources as an acquisition of net assets that is applicable to a future reporting period. Deferred outflows of resources have a positive effect on net position that is similar to assets, but are not assets, and likewise deferred inflows of resources have a negative effect on net position, but are not liabilities. Thus, the GASB requires them to be identified separately from the assets and liabilities.*

Review of Procedures to Inform Students of Advantages of Title IV Loans

ISLLC has established adequate procedures to inform students about the advantages of loans for which the students may be eligible that are available under Title IV of the Federal Higher Education Act.

Materials given to students and schools note that forms of financial aid other than borrowing should be exhausted before considering borrowing. Further, the materials note that if the student needs to borrow, federal student loans should be exhausted before private loans are considered.

Applications for private loans note in their opening paragraphs that all other sources of financial aid and loans should be exhausted before considering a private loan.

Disclosures given at the time a student or parent applies for a private student loan include extensive information about the cost of guaranteed student loans versus private student loans. In addition, the loan programs are described as supplements to – not replacement of – federal, state, or institutional sources of funding for education costs.

Verification of Compliance with Tax-exempt Bond Issuing Requirements

ISLLC did not issue any tax-exempt bonds in the period under review.

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Respectfully submitted,

Joseph T. Gordon

Joseph T. Gordon, Examiner-in-Charge

Ronald L. Hansen

Ronald L. Hansen, Iowa Superintendent of Banking

January 12, 2018

Date