AGENDA ITEM 6.

FISCAL YEAR 2017 INTERNAL BUDGET

Submitted for: Action

Action requested: Staff requests that the Commission approve the Fiscal Year 2017 budgets for the Illinois Student Assistance Commission (ISAC) Student Loan Operating Fund (SLOF), Illinois Designated Account Purchase Program (IDAPP), and the College Illinois!® Prepaid Tuition Program, as printed in the agenda book.

ILLINOIS STUDENT ASSISTANCE COMMISSION

FISCAL YEAR 2017 INTERNAL BUDGET

Appropriation

ISAC is required by statute to obtain appropriation authority from the Illinois General Assembly for expenditures from all the funds it administers. The only exceptions to this are the College Illinois!® Prepaid Tuition Program (College Illinois!) and Illinois Designated Account Purchase Program (IDAPP), which are both classified as non-appropriated funds.

- **Appropriation (State Funded)**

ISAC's state-funded appropriation represents funding authority for all the scholarship and grant programs administered by ISAC and operational expenditures of the agency. The funding for this comes from the state General Revenue Fund or other state funds and is allocated for higher education from state resources.

- **Spending Authority (Other Sources)**

With the exception of IDAPP, the cash disbursements for all funds administered by ISAC are processed by the Illinois Office of the Comptroller. Without the spending authority, payments cannot be processed from these funds, except for College Illinois!, which is a non-appropriated fund. **Note that the spending authority authorizes annual spending limits from the funds. It does not represent actual expenditures from the fund.**

- **Internal Budget**

The internal budget reflects the annual projected revenues and expenditures for the agency.

Illinois General Assembly Appropriation – Fiscal Year 2017 Budget Update

For FY 2017, based on Commission approval at the January 2016 meeting, ISAC recommended a budget totaling $799 million.

The appropriation introduced by the Governor recommended $727 million. The General Assembly has not yet passed an FY 2017 appropriation.

Please note that the FY 2017 appropriation that is ultimately passed by the General Assembly and signed by the Governor may be significantly different than the requested amounts. We will provide an update on the FY 2017 budget and, if necessary, any proposed changes at the September Commission meeting.

The attached Table – FY 2015-FY 2017 Appropriations, details the agency comparative appropriations to date.

Internal Budget Overview

The internal budget reflects the annual projected revenues and expenditures for the agency.

Please note the following about the overall ISAC operational budget:

- Most of ISAC's revenues still come from efforts related to servicing and collections tied to the FFELP portfolio. Because the FFEL program was eliminated by the Student Aid and Fiscal Responsibility Act in March 2010, this source of revenue is decreasing and will ultimately wind down to zero.

- As discussed at prior Commission meetings, the cost of running the ISACorps will continue to be paid by ISAC's Student Loan Operating Fund (SLOF) in FY 2017. Note that the ISACorps were federally funded until FY 2014 and received an appropriation from the state for only a portion of the necessary funding in FY 2015. Funding for most of the cost of operating the ISACorps was included in the Governor's proposed budget for FY17. However, we do not know how much GRF funding will be provided in the final FY17 budget.

- While we have budgeted estimated revenues, there is a level of inherent uncertainty that is discussed later in this memo.

From the cost side, there are elements of ISAC's costs, such as pension, group insurance, and data processing, which are determined by the State. In past years, we have not received advance notice of changes in these costs before they were assessed, leading to additional uncertainty in budgeting for these areas.

Some of the costs related to College Illinois! are volume driven, such as investment management fees that are tied to asset values, or investment gains and account maintenance fees that are tied to the number of contracts sold or contact usage.

We have tried to provide in the budget for some of these potential contingencies, and will of course continue to be diligent in working to minimize costs and expenditures.

The administrative expenditures for ISAC are met by the revenues generated from the three major operating funds: SLOF, IDAPP and College Illinois!, supplemented by funding from the state GRF.

Attached for your reference is a comparative individual income statement reflecting FY 2015 actual, FY 2016 budget and estimated actual and recommended FY 2017 budget for all the administrative funds for the agency.

Student Loan Operating Fund (SLOF) - FFELP Guarantor

Revenues

SLOF is the primary operating fund which accounts for the majority of ISAC's administrative expenditures. The source of funds for SLOF is the revenue generated from ISAC's role as a FFELP guarantor. ISAC has been a FFELP guarantor for over 50 years. Currently, ISAC has an outstanding FFELP portfolio of over $3.7 billion in guarantees and over $525 million in defaulted loans.

- About 60% of FFELP revenues came from the Federal Rehabilitation Program in FY 2016.
- Over the last few years ISAC has made efforts to maximize revenue from FFELP collection recoveries by helping defaulted borrowers rehabilitate their loans. Since 2012, ISAC has made significant process improvements and efficiencies. As a result, ISAC's revenue from FFELP increased in fiscal years 2012 - 2014.
- In 2014 the Bipartisan Budget Act reduced the fees earned by ISAC for rehabilitation of defaulted loans by over 60%. ISAC's projected loss of revenue in FY 2015 was estimated at over $13 million annually assuming the same volume of rehabilitations.
- In addition, the Department of Education (ED or "the Department") changed the regulations related to loan rehabilitations in FY 2014. The revisions made the rehabilitation process significantly more labor intensive for the guarantor. However it also made it easier for the borrower to rehabilitate by decreasing the amount of the required payments (borrower payments as low as $5 per month, if able to prove financial hardship.)
- In light of these federal changes and limited agency resources, in FY 2015 ISAC changed its collection strategy and outsourced a larger percentage of its collection efforts to outside collection agencies that had the resources to more cost effectively manage and maximize collection efforts.
- The new outsourcing strategy combined with the decrease in the amount of required payment for borrowers resulted in a temporary spike in the volume of rehabilitations. As a result, ISAC was able to increase the volume of rehabilitations for FY 2015 by 73%, and increased rehabilitation revenue by $9.3 million when compared to the budgeted amount.
- To further improve efficiencies and manage limited resources, ISAC made the difficult but necessary decision to implement a workforce reduction in FY 2016, and subsequently transferred substantially all collections-related services to outside collection agencies.
- Because the rehabilitation process takes approximately nine months to fund, the impact of the change in collections strategy by outsourcing continued into FY 2016.
- As a result of these changes made in collections strategy, FY 2016 FFELP revenue is projected to remain level with FY 2015, at approximately $35 million.

FFELP FY 2017 Projections

As the FFELP portfolio winds down, revenues from the portfolio will continue to shrink. ISAC management has worked in conjunction with other experts in the industry, including other guarantors and our collection partners, to come up with a reasonable projection for revenues from the FFELP for the next few years. However, there remains a level of inherent uncertainty. Forecasting the FFELP revenues accurately is extremely difficult in light of the multiple factors and multiple players impacting the program. We considered the following in developing projected revenues from the program:

- The Guarantee portfolio is decreasing at 8 – 10 % annually. As a result, the Account Maintenance Fee is decreasing at about 10% per year.
- Default claims decreased by over 25% from FY 2014 – FY 2015. Decreases in the default portfolio will decrease revenue potential from future rehabilitations.

- The decrease in claims has slowed down in FY 2016 only because of an increase in default of previously rehabilitated borrowers. Borrowers can only be rehabilitated once, so if they default again their loans cannot be rehabilitated. The percentage of loans that cannot be rehabilitated is increasing and is currently at 35-50% of new defaults. This decreases the revenue potential from future rehabilitations significantly.
- The new rehabilitation regulation that provides for payments as low as $5 could impact the FFELP securitization market significantly. This could cause a significant pullback in the market for purchase of rehabilitated loans by lenders—either loss of lender purchasers, and/or increased discounts in sale of rehabilitated loans. ISAC only receives the bulk of the rehabilitation related revenue when the rehabilitated loan is sold to a new lender.
- If the lender market crashes and there are no purchasers for rehabs, the loans would have to be assigned to ED, which would reduce rehabilitation revenues to ISAC by an estimated 67%.
- In addition, depending on the cash liquidity with ED, among other things, the Department could choose to reduce or eliminate this program at any point in time.
- It is also possible that ED could change regulations and require guarantors to transfer the loans back to the Department at any point in time. In this scenario, FFELP revenues could be zero.
- As the default portfolio continues to age, the rate of subrogation increases. YTD we have subrogated over $58 million. In the subrogation process, ISAC is required to transfer the loan to ED. Once the loan is subrogated, it leaves ISAC's FFELP portfolio and ISAC does not receive any more revenue from that loan.
- Currently, the default portfolio has decreased by over $90 million in the last eleven months of the fiscal year.

Taking into consideration the above factors, ISAC management projects total FY 2017 FFELP revenues of $24 million, a decrease of $11 million compared to estimated revenues for FY 2016.

Expenditures

The primary objective of the FY 2017 budget is to continue to ensure efficient use of scarce agency resources while simultaneously executing the core mission of the agency.

As the FFELP winds down, certain areas of the agency will continue to shrink and require fewer resources, while efforts in other areas are growing and have a critical need for additional resources. ISAC will continue to examine its organizational structure and reallocate resources based on the agency's priorities. This is a very difficult, but necessary process for the agency.

The budget proposed in this item assumes that SLOF will pay approximately $3.4 million related to the operations of the ISACorps. The cost is higher than FY16 actuals, because we were not able to hire as many ISACorps members as we planned for last year, but hope to do so to fill the significant need in FY 17. In addition, the budget assumes that all Corps members stay the full year, when typically we have some attrition during the year.

Governor Bruce Rauner created the new Illinois Department of Innovation and Technology (DoIT) to consolidate the state's information technology functions into one agency. For most State agencies, their IT departments are being consolidated into this new agency. ISAC's IT department will not be consolidated within this new agency at this time. However, ISAC's IT department will integrate with the wider State effort in the IT area and because of the highly respected expertise within ISAC, we may provide IT services to other state agencies through intra-agency agreements. Costs incurred will be reimbursed by the respective agencies. To ensure sufficient staffing in the IT division to cover for the additional services, the budget includes a $450,000 increase in personnel costs and $250,000 in contractual expenditures for consultants.

In addition, there are several operational overhead expenditures for building maintenance and for software and hardware that are critical investments to ensure continuity of the agency's services. The FY 2017 budget reflects continued expenditures for these critical needs, although at a reduced level compared to FY 2016.

The major changes in budgeted FY 2017 costs versus FY 2016 estimated actuals are outlined in the tables below.

It should be noted that although these increases in expenses are included in the budget, the decision as to whether or not to implement these increases will be made in the future, as we see how the budget year is shaping up and take into consideration other relevant factors.

Inter-fund Allocation

From FY 2006 to FY 2014, all agency administrative expenses were funded entirely through federal revenues from the FFELP program. In light of the wind-down of FFELP, beginning in FY 2014, the budget passed by the General Assembly included language to allow up to 2% of funds allocated to MAP to be used for administrative expenses. ISAC has utilized this authority since FY 2015 and will continue to do so in FY 2017.

The budget introduced by the Governor for FY 2017 included language providing that up to 2% of the MAP appropriation can be used for agency administrative and operational costs. His proposed budget also includes a separate appropriation of approximately $3.2 million for outreach expenditures to be used for operating the ISACorps, and an additional $1 million for agency operations.

ISAC management has worked in conjunction with our outside collection partners and other subject matter experts in the industry to come up with projections for revenues from the FFELP. However, forecasting the FFELP revenues accurately is extremely difficult in light of the multiple factors and multiple players impacting the program.

The agency plan for FY 2017 will be to monitor FFELP revenues on an ongoing basis and utilize GRF funding only to the extent needed to cover the shortage of funding from FFELP. ISAC would utilize the line item appropriations of $3.2 million for outreach expenditures and $1 million for agency operations first to minimize the use of operational dollars out of the line item appropriation for MAP scholarships.

Fund Balance

The unrestricted fund balance at the end of fiscal year 2016 is estimated to be over $56 million.

Fund reserves are critical for responsibly financing the wind-down of the FFELP.

- FFELP regulations require that ISAC, as a guarantor, must perform certain services for which it is not directly compensated. As the portfolio ages, FFELP revenue generated from collection recoveries from defaulted FFELP loans will be winding down rapidly. Revenue generated in future years may not be sufficient to cover all the mandated functions for an extended period.

- ISAC has approximately 500,000 borrowers in the FFELP portfolio. FFELP regulations and ISAC's records retention policy mandate that ISAC retain the loan records for a minimum of seven years after repayment of the loan. As a result, there could be significant data storage and IT security costs.

- As the portfolio decreases and the program shuts down, FFELP regulations require ISAC to transfer the borrower loan information securely and accurately back to the Department or the servicer. This will involve substantial de-conversion costs.

- There is a significant amount of personally identifiable data in these systems. The reserve will also ensure that we cover the cost of safely storing and transferring the portfolio back to the Department. This will help mitigate the significant risk to the agency from liabilities resulting from any loss of PII data—a potential loss that could be monetary and reputational for both the agency and the State.

ISAC's reserves will be needed to cover expenses to ensure that the wind-down will advance smoothly, safely, and effectively, and will not become a financial liability and risk for the state.

Personal Services

STUDENT LOAN OPERATING FUND DETAILS OF INCREASES AND DECREASES IN PERSONNEL SERVICES 2017 BUDGET OVER 2016 ESTIMATED ACTUAL EXPENDITURES		
Reserve for Employees on Leave of Absence Including Benefits	$368,400	
New Hires Including Benefits	679,700	
Personnel Resources Transfer from IDAPP	303,800	
Reserve For Cost of Living and Administrative Adjustments	1,094,800	
Savings Due to Workforce Reduction Net of Attrition	(1,996,800)	
Total Increases/(Decrease) before ISACorps Payroll		**$449,900**
Increase in ISACorps Payroll Expenses		**$853,100**
Total Payroll Increase/(Decrease)		**$1,303,000**

Contractual Services and Building Maintenance

STUDENT LOAN OPERATING FUND DETAILS OF INCREASES AND DECREASES IN CONTRACTUAL / BUILDING MAINTENANCE 2017 BUDGET OVER 2016 ESTIMATED ACTUAL EXPENDITURES		
Mainframe Support and Student Portal & Software	$150,000	
Outreach Related Expenses	13,000	
Website Development - Communication Division	150,000	
Electricity	52,800	
Other Contractual Services	72,100	
IT Audit and Other Contractual Services	250,000	
Decrease-Human Resources Information System	(170,000)	
General Ledger Accounting System Conversion	50,000	
Building Maintenance	96,300	
Total Net Increase		**$664,200**

<u>Illinois Designated Account Purchase Program (IDAPP) – Lender of Student Loans</u>

IDAPP is ISAC's lending arm for student loans. In the past, IDAPP directly originated loans; currently it services alternative student loans. The FFELP student loan disbursements and purchases were funded by bonds issued by IDAPP and collateralized with the student loan portfolio.

In 2007 IDAPP entered into a Mid Term Asset Backed Commercial Paper Program to fund its alternative loan program. IDAPP's administrative costs are met through an administrative cost allowance from the Bond Trusts and the credit facility which originally funded the alternative loan program.

IDAPP operations and loan portfolio continue to be in wind-down. As the program winds down, staffing requirements have been reduced. IDAPP's estimated expenditures have decreased and reflect reductions in force and the redeployment of staff to other areas of the agency.

<u>Prepaid Tuition Program – College Illinois!</u>

Program Update and Overview

Each year the Commission is asked to review and approve the planned administrative budget for the College Illinois! 529 Prepaid Tuition Program. The proposed Fiscal Year 2017 administrative budget has been developed to adequately cover administrative costs of the program.

Personal Services

The Personal Services line includes direct expenses for staff who work for the benefit of College Illinois!. Consistent with past practice, payments charged to College Illinois! will be based on the cost allocation data from the Time Tracker system, using actual time spent on College Illinois! by these staff members. Any time spent on other ISAC programs will not be charged to College Illinois!

Contractual Services

- **Marketing**
  The marketing budget request for FY 2017 totaling $1.7 million is comparable to prior years.
- **Records Administration and Call Center Services**
  The program's records administration vendor handles lockbox services, account servicing, including application processing, customer service, financial transaction processing, and payment of contract benefits. These charges are largely volume driven.
- **Financial Services**
  This includes costs related to custodial services, actuarial services, investment advisory services, insurance costs, legal services and audit costs.

Intra-agency Administrative Services

The Intra-agency Administrative Services component of the College Illinois! budget represents those ISAC personnel and other agency resources used to support the program. These indirect costs will be determined through the agency's cost allocation. Please note that personnel costs charged to College Illinois! will be based on actual time worked as recorded in the Time Tracker system.

COLLEGE ILLINOIS! DETAILS OF INCREASES AND DECREASES IN EXPENDITURES FY 2017 BUDGET OVER FY 2016 ESTIMATED ACTUAL EXPENDITURES FOR THE FISCAL YEAR ENDING JUNE 30.		
PERSONNEL SERVICES		
One New Position & One Temporary Position in FY17	$172,700	
Reserve for Cost of Living and Administrative Adjustments	63,900	
Estimated Direct CI! Payroll Cost Allocated to Other Fund	160,100	
Reserve for LOA Position	107,300	
TOTAL PERSONNEL SERVICES		**$504,000**
CONTRACTUAL SERVICES		
Increase in Records Administration Charges & Custodial Bank Charges	$301,200	
Increase in Management Fees Due to Cost Increase	166,200	
Increase in Legal Fees Due to More Contracts & Cost Increase	31,500	
Increase in Other Contractual Services	36,300	
TOTAL INCREASE CONTRACTUAL SERVICES		**$535,200**
INVESTMENT EXPENSE		
Increase in Investment Expenses Due to Cost Increase	$434,400	
Increase in Investment Advisory Fee Related to Allowance for Performance & Asset Growth	569,700	
		$1,004,100
OTHER ADMIN EXPENSES		
Increase in Printing, Equipment and Travel	$13,300	
TOTAL OTHER ADMIN EXPENSES		**$13,300**
TOTAL INCREASE IN COLLEGE ILLINOIS BUDGET		**$2,056,600**

Investment Expenses

Investment expense is the invoice fees paid to traditional managers (mostly equities and fixed income) and the fees paid to limited partner (LP) or subscription funds (hedge funds, etc.) that are not the private equity/closed-end fund structure. Increases are due to the potential for higher fee rates for international equity and also due to allowances for asset growth and performance fees similar to prior budgets. International equity fees may increase due to the inclusion of small capitalization and emerging market stocks as well as utilizing a commingled fund structure. In addition, it is estimated that $3.9 million in management advisory fees will be net out of investment income in FY 2017.