

**NORTHSTAR EDUCATION FINANCE, INC.
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2005 and 2004**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Northstar Education Finance, Inc.
St. Paul, Minnesota

We have audited the accompanying consolidated statements of financial position of Northstar Education Finance, Inc. and subsidiaries as of September 30, 2005 and 2004 and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northstar Education Finance, Inc. and subsidiaries as of September 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Baune Dosey & Co LLP

November 18, 2005
Minneapolis, Minnesota

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
September 30, 2005 and 2004
(in thousands)

	<u>2005</u>	<u>2004</u>
Assets		
Loans (Note 2, 4, 5, 13 and 15)	\$ 3,825,221	\$ 2,697,145
Interest receivable (Note 15)	59,155	63,368
Cash and cash equivalents (Note 2)	4,240	326
Receivable from Great Lakes	23,302	7,827
Government receivable	20,292	7,129
Restricted cash (Note 3)	292,634	178,620
Income taxes receivable	250	
Property and equipment, net	372	234
Other assets	493	563
Amortizable assets, net (Note 2)	<u>11,198</u>	<u>8,119</u>
Total assets	<u>\$ 4,237,157</u>	<u>\$ 2,963,331</u>
Liabilities and net assets		
Accounts payable and accrued liabilities	\$ 38,300	\$ 15,855
Interest payable		6
Accrued salaries and benefits	1,302	1,191
Contract servicer payable	311	221
Draw against bank lines of credit (Note 7)	1,323,000	1,071,000
Income taxes payable		500
Long-term debt (Note 8)	2,860,000	1,860,000
Notes payable (Note 6)	<u> </u>	<u>696</u>
Total liabilities	4,222,913	2,949,469
Net assets		
Net assets - unrestricted	13,925	13,836
Minority interest in subsidiary	<u>319</u>	<u>26</u>
Total net assets	<u>14,244</u>	<u>13,862</u>
Total liabilities and net assets	<u>\$ 4,237,157</u>	<u>\$ 2,963,331</u>

See accompanying notes to financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ACTIVITIES
For The Years Ended September 30, 2005 and 2004
(in thousands)

	<u>2005</u>	<u>2004</u>
Income		
Loan interest income (Note 2)	\$ 152,033	\$ 69,236
Expenses		
Loan financing expenses (Note 11)	133,839	50,517
T.H.E. bonus expense	7,325	4,391
Adjustment to allowance for credit losses	5,599	(204)
Professional services	588	600
Promotion and marketing	3,276	2,559
Amortization	837	654
Salaries and benefits	8,274	6,777
Other	<u>2,316</u>	<u>1,892</u>
Total expenses	<u>162,054</u>	<u>67,186</u>
Change in net assets before other income (expense)	(10,021)	2,050
Other income (expense)		
Interest expense	(16)	(236)
Other revenue	989	14
Derivative market value adjustment		89
Interest income	<u>11,780</u>	<u>1,748</u>
Total other income (expense)	<u>12,753</u>	<u>1,615</u>
Change in net assets before income tax provision and minority interest	2,732	3,665
Provision for income taxes on NCMS minority interest in NCMS net income	2,440	1,067
	<u>293</u>	<u>56</u>
Change in net assets	(1)	2,542
Net assets, beginning of period	13,836	11,249
Net asset adjustment from NCMS and minority stock options	<u>90</u>	<u>45</u>
Net assets, end of period	<u>\$ 13,925</u>	<u>\$ 13,836</u>

See accompanying notes to financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended September 30, 2005 and 2004
(in thousands)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities		
Change in net assets	\$ (1)	\$ 2,542
Adjustments to reconcile change in net assets to cash flows from operating activities:		
Amortization	837	654
Depreciation	104	85
Issuance of stock options for services	77	45
Loan premium expense	14,354	9,938
(Increase) decrease in current assets:		
Interest receivable	4,213	(7,923)
Receivable from Great Lakes	(15,475)	(3,049)
Government receivable	(13,163)	(4,221)
Income taxes receivable	(250)	
Other assets	70	258
Increase (decrease) in current liabilities:		
Accounts payable and accrued liabilities	22,445	5,061
Accrued salaries and benefits	111	411
Contract servicer payable	90	56
Interest payable	(6)	(302)
Income taxes payable	(500)	500
Net cash flows from operating activities	<u>12,906</u>	<u>4,055</u>
 Cash flows from investing activities		
Net increase in loans	(1,142,430)	(798,799)
Increase in restricted cash	(114,014)	(72,210)
Purchases of property and equipment	<u>(300)</u>	<u>(118)</u>
Net cash flows from investing activities	(1,256,744)	(871,127)
 Cash flows from financing activities		
Net change in draws against lines of credit	252,000	(446,000)
Proceeds from long-term debt	1,000,000	1,320,000
Payments on notes payable	(696)	(2,705)
Payments on capital lease obligations		(7)
Financing costs	(3,858)	(5,083)
Minority interest	<u>306</u>	<u>58</u>
Net cash flows from financing activities	<u>1,247,752</u>	<u>866,263</u>
 Net increase (decrease) in cash and cash equivalents	 3,914	 (809)
 Cash and cash equivalents at beginning of year	 <u>326</u>	 <u>1,135</u>
 Cash and cash equivalents at end of year	 <u>\$ 4,240</u>	 <u>\$ 326</u>

See accompanying notes to financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 1 BUSINESS OPERATIONS

Northstar Education Finance, Inc. (“NEF” or the “Company”) was organized and is operated exclusively for charitable and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. The purposes for which NEF was formed are to foster, aid, encourage and assist the pursuit of higher education. NEF received a favorable determination from the Internal Revenue Service that it is an organization described in Section 501(c)(3) in March of 2003.

NEF accomplishes its mission and purpose of reducing the cost of higher education through the T.H.E. Loan Program, a trademarked suite of loan products. NEF formed Northstar Capital Markets Services, Inc., (“NCMS”) a Delaware for-profit business corporation to administer the T.H.E. Loan Program and potentially provide services to third parties. NEF currently owns 95% of NCMS’s issued and outstanding capital stock.

All T.H.E Loan Program loans, related financial assets and associated liabilities are assets or liabilities of NEF, either directly or through one or more wholly-owned limited liability company subsidiaries (Northstar T.H.E. Funding, LLC [T.H.E.], Northstar T.H.E. Funding II, LLC [T.H.E. II], and Northstar T.H.E. Funding III, LLC [T.H.E. III]). Any potential claims against or liabilities of a subsidiary would be payable only out of the assets of that subsidiary. Operating assets and associated liabilities are assets or liabilities of NCMS. NCMS has entered into Administration Agreements with NEF and its limited liability company subsidiaries to provide general management services, to originate, service and finance the T.H.E. Program Loans and to perform certain specific duties under the terms of certain contracts to which such entities are parties.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and cash equivalents

Cash and cash equivalents consist of checking accounts, cash management accounts, money market funds, and other operating accounts invested in short-term highly liquid investments with initial maturities of three months or less. Cash pledged as collateral for bank lines and long-term debt (as described in Note 7 and 8) is excluded from cash and cash equivalents and is presented in these financial statements as restricted cash and cash equivalents.

Loans and allowance for credit losses

Investments in student loans, including premiums, are recorded at cost, net of premium amortization and the allowance for credit losses. Interest income is calculated by using the simple interest method on daily balances outstanding. Premiums are amortized using the interest method over the estimated ten-year principal life of the related loans. Premium amortization expense is offset against loan interest earnings when recording loan interest income.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

In accordance with the indenture trust agreements, the allowance for credit losses is estimated and established by increasing restricted cash when private loans are disbursed and additional provisions as may be required. Loans are charged against the allowance when the loans are 180 days delinquent and the indenture trustee may withdraw funds from the restricted cash accounts. Recovery of amounts charged off are credited to the allowance for credit losses. The allowance for credit losses is estimated and based on management's evaluation of the loan portfolio, including such factors as the volume and type of loans outstanding, credit scores of borrowers, past loan loss experience, and general economic conditions.

Management believes that the allowance for credit losses is adequate. While management used available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions.

Restricted cash and cash equivalents

The Company's restricted cash is held by the trustee in various accounts subject to use restrictions, imposed by the indenture of trust. Restricted cash and cash equivalents consist of cash management accounts, money market funds, and other operating accounts invested in high quality short-term financial instruments. The amounts may exceed federally insured limits.

Amortizable assets

The Company's amortizable assets consist of financing costs and student loan servicing rights. The financing costs are amortized over the principal life of the corresponding debt. The servicing rights are amortized over fifteen years.

Derivative accounting

Derivative instruments that are used as part of the Company's interest rate risk management strategy include interest rate floor and cap contracts with indices that relate to the pricing of specific statement of financial position assets and liabilities. The Company follows Statement of Financial Accounting Standards ("SFAS") No. 133 which requires that every derivative instrument, including certain derivative instruments embedded in other contracts, be recorded in the statement of financial position as either an asset or liability measured at its fair value. These amounts are currently presented in the statement of financial position caption "accounts payable and accrued liabilities". Under SFAS No. 133, if certain criteria are met, derivative instruments are classified and accounted for as either fair value or cash flow hedges. If these criteria are not met, the derivative financial instruments are accounted for as trading. The Company sells interest rate floors to partially offset the embedded floor income options in student loan assets. This relationship does not satisfy hedging qualifications under SFAS No. 133, but are considered economic hedges for risk management purposes. The Company uses this strategy to minimize its exposure to floating rate volatility.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

Income taxes

The Company is tax-exempt under the provisions of the Internal Revenue Code Section 501(c)(3). However, a provision for income taxes has been made in the accompanying financial statements for NCMS, its for-profit business subsidiary.

Deferred taxes are recorded to reflect the tax consequences on future years of differences between the tax bases of assets and liabilities and the financial reporting amounts at each year end of NCMS.

Principles of consolidation

The consolidated financial statements include the accounts of NEF and its subsidiaries (T.H.E. , T.H.E. II, T.H.E. III and NCMS). All significant intercompany transactions have been eliminated in consolidation.

Loan interest income

The Company's portfolio of student loans originated under the FFELP has a variety of interest rate characteristics. The Company earns interest at the greater of the borrower's rate or a floating rate determined by reference to the average of the 90-day financial commercial paper, plus a fixed spread which is dependent upon when the loan was originated. If the floating rate exceeds the borrower rate, the Department of Education makes a payment directly to the Company based upon the special allowance payment ("SAP") formula established under the Higher Education Act. If the floating rate is less than the rate the borrower is obligated to pay, the Company simply earns interest at the borrower rate. In all cases, the rate a borrower is obligated to pay is the lowest interest rate or the floor that the Company can earn on a student loan. The borrowers' interest rates are either fixed to term or are reset annually on July 1 of each year depending on loan type. The Private student loans have variable interest rates that reset quarterly.

Loan interest expense

The Company generally finances its student loan portfolio with floating rate debt tied to commercial paper rates. Such borrowings float over all interest rate ranges. As a result, in periods of declining interest rates, the portfolio of managed student loans may be earning at the borrower rate while the Company's funding costs (exclusive of fluctuations in funding spreads) continue to decline along with commercial paper rates. When this happens, the difference between the interest earned from the rate paid by the borrower and the interest that would be earned as derived from the SAP formula is referred to as "Floor Revenue". For loans where the borrower's interest rate is fixed to term, declining interest rates may benefit the spread earned on student loans for extended periods of time. For loans where the borrower's interest rate is reset annually, any benefit of a declining interest rate environment will only enhance student loan spreads through the next annual reset of the borrower's interest rates, which occurs on July 1 of each year.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

Stock options

In accordance with FASB Statement 123, stock options for NCMS are recorded under the fair value method and compensation cost is recognized for stock-based employee compensation.

Advertising

The Company expenses promotion and marketing costs as they are incurred.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Disclosures about fair value of financial instruments

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires that the Company disclose estimated fair values for its financial instruments.

The following methods and assumptions are used by the Company in estimating the fair value of its financial instruments.

Cash and cash equivalents: The carrying amount of cash and cash equivalents is a reasonable estimate of fair value.

Loans: The estimates of fair value on loans are based on collateral coverage certificate amounts as determined by the indenture of trust.

Interest receivable: Interest receivable is based on the loans listed above; therefore, the estimates of fair value are based on the collateral coverage certificate amounts.

Receivable from Great Lakes: The carrying amount approximates fair value due to the short maturity of this receivable.

Restricted cash: The carrying amount of restricted cash is a reasonable estimate of fair value.

Accounts payable and accrued liabilities: The carrying amount approximates fair value due to the short maturity of these instruments.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

Draw against bank lines of credit: The fair value of the lines of credit approximate carrying value due to the variable interest rate nature of the financing arrangement.

Long-term debt: The fair value of long-term debt approximate carrying value due to the variable interest rate nature of the financing arrangement.

Derivative financial instruments: The fair value of derivative financial instruments are determined through quoted market prices representing the amount at which the instruments can be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no public market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economics conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect estimates. In addition, the tax ramifications related to the realization of the unrealized gains or losses can have a significant effect on fair value estimates and have not been considered in the estimates.

NOTE 3 RESTRICTED CASH AND CASH EQUIVALENTS

The restricted cash and cash equivalents components of loans in the statement of financial position at September 30, 2005 and 2004 are as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Accounts pledged to financings	\$ 275,200	156,670
Accounts pledged to pay default claims	<u>17,434</u>	<u>21,950</u>
Total	<u>\$ 292,634</u>	<u>\$ 178,620</u>

NOTE 4 LOANS

The components of loans in the statement of financial position at September 30, 2005 and 2004 are as follows (in thousands):

	<u>2005</u>	<u>2004</u>
Federal guaranteed student loans	\$ 3,287,163	2,294,785
Private student loans	492,013	358,666
Unamortized loan premium	78,712	57,906
Loans and refunds in process	<u>(20,437)</u>	<u>(4,679)</u>
Total	3,837,451	2,706,678
Allowance for credit losses	<u>(12,230)</u>	<u>(9,533)</u>
Net book value	<u>\$ 3,825,221</u>	<u>\$ 2,697,145</u>

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

As of September 30, 2005, the Company has committed to fund student loans totaling \$426 million.

NOTE 5 ALLOWANCE FOR CREDIT LOSSES

Analysis of the change in the allowance for credit losses for the year ended September 30, 2005 and 2004 follows (in thousands):

	<u>2005</u>	<u>2004</u>
Beginning balance	\$ 9,533	\$ 7,994
Provision for loan losses	5,600	2,375
Charge offs	(3,231)	(1,498)
Recoveries	<u>328</u>	<u>662</u>
Net charge-offs	<u>(2,903)</u>	<u>(836)</u>
Ending balance	<u>\$ 12,230</u>	<u>\$ 9,533</u>

At September 30, 2005 loans totaling \$15 million were 91 days or more delinquent. Of these, \$11 million were federally guaranteed loans.

NOTE 6 NOTES PAYABLE (IN THOUSANDS)

	<u>2005</u>	<u>2004</u>
Note payable – bank, secured by servicing rights on loan portfolio. This note requires monthly payments at an annual rate of 1% over the prime rate. This note was paid in full in 2005.		\$ 150
Note payable – non-profit organization. This unsecured Note requires monthly payments at the higher of 12% or 4% annual rate over the prime rate. This note was paid in full in 2005.	<u> </u>	<u>546</u>
Total	<u>\$ -</u>	<u>\$ 696</u>

NOTE 7 DRAW AGAINST BANK LINES OF CREDIT

The Company has three lines of credit with interest at varying rates (interest rates were 3.62% to 3.75% at September 30, 2005) depending on funding sources. These lines grant maximum credit of \$1.75 billion. Amounts outstanding are due on demand, and are secured by student loans. The Company had amounts outstanding of \$1.32 and \$1.07 billion at September 30, 2005 and 2004.

In connection with the line of credit agreement, the Company is required, among other things, to maintain certain covenants and ratios. As of September 30, 2005, the Company was in compliance with these requirements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 8 LONG-TERM DEBT

The Company periodically issues taxable student loan asset-backed notes to finance the acquisition of student loans. All notes are primarily secured by the student loans receivable, related accrued interest, and other property and funds held in trust. The notes are variable rate notes with interest rates reset periodically. The Company issues Floating Rates Notes (FRNs) which are issued at a fixed spread to 3 month LIBOR and at a fixed maturity with targeted amortization schedules. The interest rates on these notes reset quarterly. The Company also issues Senior and Subordinate Auction Rate Securities. The interest rates on these securities are usually reset every 28 days based upon auction procedures. These securities have a forty year maturity with prepayment at the option of the Company.

The securities are issued out of two master trusts, one trust contains only Federal guaranteed student loans and the other contains only private student loans.

The table below summarizes outstanding notes payable at September 30, 2005 and 2004 by issue (in thousands):

<u>Auction Rate Student</u> <u>Loan Asset-Backed Notes</u>	<u>Maturity</u>	<u>2005</u> <u>Carrying</u> <u>Amount</u>	<u>2004</u> <u>Carrying</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>
Senior Series 2000	11/1/2040	\$ 100,500	\$ 100,500	3.61%
Subordinate Series 2000B	11/1/2040	9,500	9,500	3.64%
Senior Series 2002	4/1/2042	393,000	393,000	3.55%
Subordinate Series 2002B	4/1/2042	37,000	37,000	3.68%
Senior Series 2004	12/1/2044	220,000	220,000	3.57%
Subordinate Series 2004B	12/1/2044	30,000	30,000	3.75%
Series 2004-A Private loans	12/1/2004	320,000	320,000	3.63%
Series 2004-2B	12/28/2044	25,500		3.75%
Total Auction Rate Securities		<u>1,135,500</u>	<u>1,110,000</u>	
<u>Floating Rate Notes</u> <u>Loan Asset-Backed Notes</u>	<u>Maturity</u>	<u>2005</u> <u>Carrying</u> <u>Amount</u>	<u>2004</u> <u>Carrying</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>
Senior Series 2004-1A-1	1/28/2011	100,000	100,000	3.72%
Senior Series 2004-1A-2	1/28/2014	225,000	225,000	3.79%
Senior Series 2004-1A-3	4/28/2017	200,000	200,000	3.84%
Senior Series 2004-1A-4	4/29/2019	225,000	225,000	3.86%
Series 2004-2A-1	4/28/2016	295,000		3.79%
Series 2004-2A-2	1/30/2017	150,000		3.81%
Series 2004-2A-3	7/30/2018	280,000		3.84%
Series 2004-2A-4	7/28/2021		249,500	3.90%
Total Floating Rate Notes		<u>1,724,500</u>	<u>750,000</u>	
Total Long-term Debt		<u>\$ 2,860,000</u>	<u>\$ 1,860,000</u>	

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

The following is a schedule of long-term debt maturities as of September 30, 2005 (in thousands):

2006	\$ 10,000
2007	71,000
2008	78,000
2009	124,325
2010	156,495
Remainder	<u>2,420,180</u>
Total	<u>\$ 2,860,000</u>

NOTE 9 INCOME TAXES

Provision for (benefit from) income taxes

The components of income tax provision consists of the following (in thousands):

	<u>2005</u>	<u>2004</u>
Current:		
Federal	\$ 1,740	\$ 620
State	<u>600</u>	<u>212</u>
	2,340	832
Deferred:		
Federal	80	185
State	<u>20</u>	<u>50</u>
	<u>100</u>	<u>235</u>
Total	<u>\$ 2,440</u>	<u>\$ 1,067</u>

The income tax provision is based on the pre-tax income of NCMS which is \$6,692 thousand and \$2,691 thousand as of September 30, 2005 and 2004, respectively.

Deferred income taxes

As of September 30, 2005 and 2004, deferred tax assets consist of the following (in thousands):

	<u>2005</u>	<u>2004</u>
Assets:		
Accrued liabilities	\$ 365	370
Stock options		115
Depreciation and amortization	<u>35</u>	<u>15</u>
Net deferred tax assets	<u>\$ 400</u>	<u>\$ 500</u>

The net deferred tax assets are recorded in the statement of financial position caption "other assets".

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 10 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	<u>2005</u>	<u>2004</u>
Cash paid for interest (in thousands)	\$ 96,916	\$40,206
Cash paid for income taxes (in thousands)	2,598	332

NOTE 11 LOAN FINANCING EXPENSES

Loan financing expenses consist of the following (in thousands)	<u>2005</u>	<u>2004</u>
Interest expense	\$ 109,604	\$42,939
Program and commitment fees	<u>24,235</u>	<u>7,578</u>
	<u>\$ 133,839</u>	<u>\$50,517</u>

NOTE 12 EMPLOYEE BENEFITS

NCMS has a 401(k) defined contribution plan for employees who have attained age 19 and completed three months of service. Plan benefits are 100% vested at the completion of three years of service. Prior to the completion of three years of service, vesting is graduated. Employees may contribute up to the maximum percentage allowable not to exceed the limits of Code Sections 401(k), 404 and 415. NCMS matches employee contributions on a discretionary basis. In addition, NCMS can also contribute additional amounts to all participants on a discretionary basis, which is not limited to Company profitability. NCMS's total contributions were \$456 thousand for the year ended September 30, 2005 and \$363 thousand for the year ended September 30, 2004.

NOTE 13 CONCENTRATION OF CREDIT RISK

The Company receives program fees from their primary contract loan services. These amounts are generally unsecured.

The Company originates and holds student loans from students throughout the United States. The Company grants credit for private loans which are generally unsecured. The government subsidized loans are substantially guaranteed. The Company's ability to collect loans and interest from students may be affected by general economic fluctuations.

NOTE 14 DERIVATIVE FINANCIAL INSTRUMENTS

Risk Management Strategy

The Company maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize the economic effect of interest rate volatility. The Company's goal is to manage interest rate sensitivity by entering into floor income contracts which partially offset the embedded floor income options in FFEL student loan assets. The result is more consistent cashflows received on student loans and a more consistent return or yield overall. The Company views this strategy as prudent management of interest rate sensitivity and overall cashflows. Management believes Floor Income Contracts are economically effective; those transactions, however, do not qualify for hedge accounting under SFAS No. 133 (as discussed below) and thus may adversely impact earnings.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
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By using derivative instruments, the Company is exposed to credit and market risk. However, management considers the credit risk to be minimal. In addition, the Company further minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically. The Company also requires all derivative contracts be governed by the International Swaps and Derivative Association Master Agreement.

Floor income contracts

The Company enters into Floor Income Contracts with third parties, under which the Company receives an upfront payment and agrees to pay the difference between a fixed rate, which is based on the minimum borrower interest rate less the applicable SAP rate (“the Strike Rate”) and the average of LIBOR over the period of the contract. If the Strike Rate is less than the average LIBOR rate, then no payment is required.

For the period ended September 30, 2004, no floor income contracts existed and payments by the Company to floor income contract counterparties under contracts totaled \$185 thousand.

Interest rate cap

During 2004 the Company entered into an interest rate cap with a counterparty. Under this agreement the counterparty pays to the Company on a monthly basis, the excess, if any, of one month Libor over 5% times the notional amount of \$300 million. This cap expired July 1, 2005.

Summary of derivative financial statement impact

The following table summarizes the notional value of all derivative instruments at September 30, 2005 and 2004, and their impact on earnings for the year then ended (in thousands). No derivative instruments existed as of September 30, 2005.

<u>Derivatives designated "Trading"</u>	<u>2005</u>	<u>2004</u>
<i>Notional Values</i>		
Floor income contracts	\$ 0	\$ 0
Interest rate cap	\$ 0	\$ 300,000
<i>Earnings summary</i>		
Mark-to-market earnings	\$ 0	89
Total earnings impact	\$ 0	89

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 15 ESTIMATED FAIR VALUES

The Company has estimated fair values of financial instruments as follows (in thousands):

	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Excess of Fair Value Over Carrying Amount</u>
Earning assets			
Loans	\$ 3,825,221	\$ 3,895,001	\$ 69,780
Interest receivable	59,155	60,079	924
Cash and cash equivalents	4,240	4,240	-
Receivable from Great Lakes	23,302	23,302	-
Government receivable	20,292	20,292	-
Restricted cash	292,634	292,634	-
Non-interest and interest-bearing liabilities			
Accounts payable and accrued liabilities	38,300	38,300	-
Accrued salaries and benefits	1,302	1,302	-
Contract servicer payable	311	311	-
Draw against bank line of credit	1,323,000	1,323,000	-
Long-term debt	2,860,000	2,860,000	-

NOTE 16 COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases two facilities for its operations. The first facility is under a non-cancelable operating lease that expires December 31, 2009. The second facility is under a non-cancelable operating lease that expires September 30, 2009.

Future minimum operating lease payments as of September 30, 2005 are (in thousands):

2006	\$ 283
2007	284
2008	286
2009	287
2010	<u>50</u>
Total	<u>\$ 1,190</u>

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NOTE 17 SUBSEQUENT EVENTS

Student loan asset-backed note offering

On October 25, 2005, the Company issued student loan asset-backed notes to refinance student loans totaling \$1.02 billion.

Derivative transactions

The Company entered into derivative agreements as part of the student loan asset-backed note offering on October 25, 2005.