NORTHSTAR EDUCATION FINANCE, INC.
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009 and 2008

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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, 2009 and 2008 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, 2009 and 2008, 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 Dosen & Co LLP

January 4, 2010
Minneapolis, Minnesota

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
September 30, 2009 and 2008
(in thousands)

	2009	2008
Assets		
Cash and cash equivalents (Note 2)	$ 11,937	$ 5,119
Loans, net (Notes 2, 5, and 6)	5,907,509	6,272,341
Interest receivable	305,539	289,439
Accounts receivable	2,380	2,842
Receivable from Great Lakes (Note 2)	13,333	10,655
Government receivable (Note 2)		9,761
Restricted cash and cash equivalents (Notes 2 and 3)	181,039	249,651
Investment securities (Notes 2 and 4)	5,984	6,596
Amortizable assets, net (Note 2)	13,667	15,309
Other assets	924	773
Property and equipment, net	275	415
Total assets	$ 6,442,587	$ 6,862,901
Liabilities and net assets		
Accounts payable and accrued liabilities	$ 21,461	$ 42,472
Government payable (Note 2)	26,429	4,372
Accrued salaries and benefits	1,612	1,681
Contract servicer payable	458	470
Income taxes payable	710	600
Government participation payable (Note 7)		87,245
Draw against bank lines of credit (Note 8)	1,988,609	2,145,900
Long-term debt (Note 9)	4,324,909	4,525,714
Total liabilities	6,364,188	6,808,454
Net assets		
Net assets - unrestricted	74,194	49,492
Minority interest in subsidiary	4,205	4,955
Total net assets	78,399	54,447
Total liabilities and net assets	$ 6,442,587	$ 6,862,901

See accompanying notes to consolidated financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ACTIVITIES
For The Years Ended September 30, 2009 and 2008
(in thousands)

	2009	2008
Income		
Loan interest income (Note 2)	$ 221,035	$ 359,092
Servicing revenue	8,348	
Total income	229,383	359,092
Expenses		
Loan financing expenses (Note 12)	171,189	306,106
T.H.E. bonus expense	3,369	5,130
Provision for loan losses	4,505	6,009
Amortization	1,773	1,842
Salaries and benefits	10,556	11,742
Professional services	3,196	1,412
Promotion and marketing	3	1,957
Donations and grants	388	631
Other	3,025	3,029
Total expenses	198,004	337,858
Change in net assets before other income	31,379	21,234
Other income		
Other revenue	977	1,136
Derivative market value adjustment (Note 15)	542	2,241
Interest income	1,994	9,616
Total other income	3,513	12,993
Change in net assets before income tax provision and minority interest	34,892	34,227
Provision for income taxes (Note 10)	(6,201)	(5,007)
Minority interest	(3,989)	(3,208)
Change in net assets	24,702	26,012
Net assets, beginning of period	49,492	23,480
Net assets, end of period	$ 74,194	$ 49,492

See accompanying notes to consolidated financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended September 30, 2009 and 2008
(in thousands)

	2009	2008
Cash flows from operating activities		
Change in net assets	$ 24,702	$ 26,012
Adjustments to reconcile change in net assets to cash flows from operating activities:		
Amortization	1,773	1,842
Depreciation	210	227
Issuance of stock options for services		4
Provision for loan losses	4,505	6,009
Loan premium expense	4,123	2,021
Investment impairment	612	204
(Increase) decrease in assets:		
Interest receivable	(16,100)	(95,950)
Accounts receivable	462	(2,842)
Receivable from Great Lakes	(2,678)	(1,702)
Government receivable	9,761	27,533
Other assets	(151)	(404)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(21,011)	(23,327)
Government payable	22,057	4,372
Accrued salaries and benefits	(69)	(71)
Contract servicer payable	(12)	27
Income taxes payable	110	295
Net cash flows from operating activities	28,294	(55,750)
Cash flows from investing activities		
Net change in loans	356,204	(569,933)
Net change in restricted cash	68,612	48,960
Net change in notes receivable		22,018
Purchase of investment securities		(4,950)
Proceeds from sale of investments		4,000
Cash paid for amortizable assets	(131)	(758)
Purchases of property and equipment	(70)	(118)
Net cash flows from investing activities	424,615	(500,781)
Cash flows from financing activities		
Proceeds from government participation payable		87,245
Payments on government participation payable	(87,245)	
Net change in draw against bank lines of credit	(157,291)	609,900
Payments on long-term debt	(200,805)	(140,850)
Minority interest	(750)	2,200
Net cash flows from financing activities	(446,091)	558,495
Net increase (decrease) in cash and cash equivalents	6,818	1,964
Cash and cash equivalents at beginning of year	5,119	3,155
Cash and cash equivalents at end of year	$ 11,937	$ 5,119

See accompanying notes to consolidated 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 Company is a Delaware non-stock, non-profit corporation, incorporated in January, 2000. 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 by 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 56% of NCMS’s issued and outstanding capital stock and nine members of NCMS's management collectively own 42%. The remaining 2% of outstanding stock is owned by a foundation.

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. The term of the administration agreements generally expire when no amounts remain unpaid under the indentures currently in place. The maturities of certain notes in the indentures exceed twenty years.

During 2006, NCMS created a subsidiary called Northstar SAL Funding, LLC (SAL). SAL entered into a financing arrangement with four graduate schools under the School as Lender program which is a specific program outlined under the Higher Education Act. Under this program, SAL provided a line of credit to the schools. The schools drew on this line of credit to make Federally Guaranteed Stafford loans to their students. Approximately sixty days after the loans were fully disbursed, T.H.E. purchased these loans from the schools for a premium. The schools were required to use these premiums for need-based aid programs after an allowance for administrative costs. This program was discontinued in May 2008 and SAL has no assets or liabilities at September 30, 2008. SAL was officially dissolved in July 2009.

In February 2008, the assets and liabilities of the wholly-owned limited liability company T.H.E. were assumed by NEF and the subsidiary is no longer in operation.

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 (see Note 8 and 9) 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 principal life of the related loans. Consolidation loans have an estimated twenty-five year life and the remaining loans have an estimated ten year life. Premium amortization expense is offset against loan interest earnings when recording loan interest income.

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 based on the repayment status of student loans. 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, past loan loss experience, and general economic conditions. Federal student loans are federally guaranteed ranging from 97% to 100% of the principal and interest balances. No provision for loan losses is deemed necessary for the federal loans and the allowance for credit losses is based entirely on private loans.

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.

Loan premiums

Loan premiums consist of origination and lender fees paid to the U.S. Department of Education (DOE) on federal loans originated by the Company, premiums paid in the acquisition of student loans and certain origination expenses incurred to originate student loans. The Company utilizes the interest method to amortize deferred costs as an adjustment to net interest income, taking into account actual loan prepayments.

Receivable from Great Lakes

Receivable from Great Lakes (a third party servicer) represents student loan principal and interest payments collected by Great Lakes that have not yet been remitted to the Company. No allowance was deemed necessary as of September 30, 2009 and 2008.

Government receivable

Government receivable represents subsidized student loan interest income and special allowance due from the DOE. No allowance was deemed necessary as of September 30, 2008.

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.

Investment securities

Investments are initially recorded at their acquisition cost, including brokerage and transaction fees if purchased, and at a fair value at the date of donation, if received as a contribution.

Investments are carried at fair market value. The net realized and unrealized gains (losses) on investments are reflected in the statement of activities in unrestricted revenue, unless donor stipulations temporarily or permanently restrict investment income.

Investments consist entirely of auction rate bonds. NCMS purchased $6.8 million of securities issued by NEF.

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 assessed for impairment each year.

Government payable

Government payable represents payments due to the DOE for excess interest earned on loans in excess of subsidized student loan interest and special allowances due from the DOE on federal loans.

Derivative accounting

Derivative instruments that are used as part of the Company's interest rate risk management strategy include swaps and interest rate floor and cap contracts with indices that relate to the pricing of specific statement of financial position assets and liabilities. Derivative instruments, including certain derivative instruments embedded in other contracts, are 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.” Not-for-profit entities such as the Company are not permitted to use cash flow hedge accounting, therefore all gains or losses are recorded in the statement of activities and reflected as a change in net assets in the period of change.

Income taxes

The Company is a tax-exempt organization set up 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. These amounts are presented in the statement of financial position caption “other assets."

Management accounts for uncertainty in income taxes by using the guidance provided for accounting for contingencies.

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, NCMS and SAL). All significant intercompany transactions have been eliminated in consolidation.

Loan interest income

The Company's portfolio of student loans originated under the Federal Family Education Loan Program (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 earns interest at the borrower rate on all loans with first disbursements prior to April 1, 2006. For loans with first disbursements on or after April 1, 2006, the Company must remit back to the Department of Education on a quarterly basis any borrower interest in excess of the SAP formula. The borrowers' interest rates are either fixed to term or are reset annually on July 1 of each year depending on the 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 or LIBOR.

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.

Reclassifications

Certain reclassifications were made to prior year amounts to conform to current year classifications.

NOTE 3 RESTRICTED CASH AND CASH EQUIVALENTS

The components of restricted cash and cash equivalents in the statement of financial position at September 30, 2009 and 2008 are as follows (in thousands):

	2009	2008
Accounts pledged to financings	$ 135,061	$ 216,628
Accounts pledged for liquidity and default reserves	45,978	33,023
Total	$ 181,039	$ 249,651

NOTE 4 INVESTMENT SECURITIES

The amortized cost of investment securities and their approximate fair values at September 30, were as follows (in thousands):

	2009		2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Auction rate securities	$ 6,800	$ 5,984	$ 6,800	$ 6,596

There were no gross unrealized holding gains and losses on investment securities at September 30, 2009 and 2008.

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities. Fair value techniques are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The Company only has financial assets whose primary drivers are unobservable (Level 3). The change in the fair values of the financial assets that are measured at fair value on a recurring basis were as follows (in thousands):

	Level 3
Auction rate securities	
Balance at September 30, 2008	$ 6,596
Other than temporary investment impairment	(612)
Balance at September 30, 2009	$ 5,984

The scheduled contractual maturities of investment securities at September 30, 2009 are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due after ten years	$ 6,800	$ 5,984

NOTE 5 LOANS

The components of loans in the statement of financial position at September 30, 2009 and 2008 are as follows (in thousands):

	2009	2008
Federal guaranteed student loans	$ 5,164,689	$ 5,500,525
Private student loans	631,030	657,321
Unamortized loan premium	130,669	135,863
Loans and refunds in process	(131)	(2,793)
Total	5,926,257	6,290,916
Allowance for credit losses	(18,748)	(18,575)
Net loans	$ 5,907,509	$ 6,272,341

As of September 30, 2009, the Company has committed to fund student loans totaling approximately $972 thousand.

NOTE 6 ALLOWANCE FOR CREDIT LOSSES

Analysis of the change in the allowance for credit losses on private loans for the year ended September 30, 2009 and 2008 follows (in thousands):

	2009	2008
Beginning balance	$ 18,575	$ 16,638
Provision for loan losses	4,505	6,004
Charge-offs, net of recoveries	(4,332)	(4,067)
Ending balance	$ 18,748	$ 18,575

At September 30, 2009 loans totaling approximately $55 million were 91 days or more delinquent. Of the total delinquent loans over 91 days approximately $50 million were federal guaranteed student loans and approximately $5 million were private student loans.

NOTE 7 GOVERNMENT PARTICIPATION PROGRAM

During 2009 and 2008, the DOE purchased participation interests in pools of Federal loans owned by the Company. Amounts funded under this program had to be either refinanced by the Company or sold to the DOE prior to its expiration date on September 30, 2009. The DOE charged interest at a rate of commercial paper plus .50% on the principal amount outstanding. The Company participated and ultimately sold approximately $205 million during fiscal 2009. The Company had amounts outstanding of $0 and approximately $87 million as of September 30, 2009 and 2008, respectively. In December 2008, the DOE approved a renewal of the Participation Program for funding student loans for the 2009-2010 school year however the Company decided not to participate for the 2009-2010 year.

NOTE 8 DRAW AGAINST BANK LINES OF CREDIT

The Company has four lines of credit with interest at varying rates (interest rates were 0.26% to 0.32% at September 30, 2009) depending on funding sources. These lines granted maximum credit of approximately $2 billion and $2.15 billion at September 30, 2009 and 2008. Amounts outstanding are due on demand, and are secured by student loans. The Company had amounts outstanding of $1.99 billion and $2.15 billion at September 30, 2009 and 2008. In connection with the line of credit agreement, the Company is required, among other things, to maintain certain covenants and ratios. Due to the disruption in the credit markets, the bank-assigned valuation of the student loans collateralizing these lines of credit have declined below the levels the Company is required to maintain. Certain lenders have the right to request additional collateral and have done so. At September 30, 2009 the Company has not fully complied with these requests. The lines of credit are non-recourse and the lenders' remedies are generally limited to foreclosing on the loans. The lenders have not exercised their right to foreclose on the student loan collateral but some of the lenders have not waived their right to do so. The Company is in discussions with the lenders and does not anticipate that the lenders will foreclose.

NOTE 9 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, 2009 and 2008 by issue (in thousands):

Auction Rate Student Loan Asset-Backed Notes	Final Maturity	2009 Carrying Amount	2008 Carrying Amount		Interest Rate
Series 2000-B	11/1/2040	$ 9,500	$ 9,500		2.48%
Series 2002	4/1/2042	233,500	233,500		1.83-2.23%
Series 2002-B	4/1/2042	37,000	37,000		2.99%
Series 2004-B	12/1/2044	30,000	30,000		1.24%
Auction Rate Student Loan Asset-Backed Notes	**Final Maturity**	**2009 Carrying Amount**	**2008 Carrying Amount**		**Interest Rate**
Series 2004-2B	2/28/2044	25,500	25,500		1.75%
Series 2005-1B	10/30/2045	20,000	20,000		1.75%
Series 2007-1A	1/29/2046	410,150	410,150		1.75%
Series 2007-1B	1/28/2047	32,200	32,200		1.75%
Total Auction Rate Securities		797,850	797,850		
Floating Rate Notes Loan Asset-Backed Notes	**Final Maturity**	**2009 Carrying Amount**	**2008 Carrying Amount**		**Interest Rate**
Series 2004-1A-2	1/28/2014	74,000	166,000		0.62%
Series 2004-1A-3	4/28/2017	200,000	200,000		0.67%
Series 2004-1A-4	4/29/2019	225,000	225,000		0.69%
Series 2004-2A-1	4/28/2016	262,675	295,000		0.62%
Series 2004-2A-2	1/30/2017	150,000	150,000		0.64%
Series 2004-2A-3	7/30/2018	280,000	280,000		0.67%
Series 2004-2A-4	7/28/2021	249,500	249,500		1.75%
Series 2005-1A-1	10/28/2026	193,100	193,100		0.60%
Series 2005-1A-2	7/28/2027	118,300	118,300		0.63%
Series 2005-1A-3	10/30/2030	227,900	227,900		0.67%
Series 2005-1A-4	4/28/2032	210,700	210,700		0.73%
Series 2006-A1	11/30/2020	347	36,827		0.41%
Series 2006-A2	11/28/2023	111,290	111,290		0.56%
Series 2006-A3	5/28/2026	112,931	112,931		0.58%
Series 2006-A4	8/28/2035	208,056	208,056		0.72%
Series 2006-B1	11/28/2035	65,260	65,260		0.92%
Series 2007-1A-1	4/28/2030	193,000	193,000		0.60%
Series 2007-1A-2	1/29/2046	200,000	200,000		0.52%
Series 2007-1A-3	1/29/2046	235,000	235,000		0.56%
Total Floating Rate Notes		3,317,059	3,477,864		
Fixed Rate Notes Loan Asset-Backed Notes	**Final Maturity**	**2009 Carrying Amount**	**2008 Carrying Amount**		**Interest Rate**
Series 2005-1A-5	10/30/2045	210,000	250,000	*	1.25%
Total Long-term Debt		$ 4,324,909	$ 4,525,714		

*This note involves a fixed rate derivative product as discussed in Note 15.

The following is a schedule of anticipated long-term debt principal reductions as of September 30, 2009 (in thousands):

2010	$ 162,495
2011	200,095
2012	208,844
2013	212,761
2014	213,233
Remainder	3,327,481
Total	$ 4,324,909

At September 30, 2008, we had issued $798 million of taxable auction rate securities. Since February 2008, a disruption in the auction rate securities market as a whole led to failures of the auctions pursuant to which certain of our auction rate securities' interest rates are set. Because of this disruption, all of the Company's auction rate securities as of September 30, 2008 bore interest at the maximum rate allowable under their terms. The maximum allowable interest rate on our $798 million of taxable auction rate securities is generally set at the 90 day Treasury Bill plus 1.20% on the AAA rated securities and the 90 day Treasury Bill plus 1.50% on the A rated securities. The rate resets every 28 days. The maximum rate is tied to a rolling 13 reset period average.

The Company has also issued reset rate notes. Reset rate notes are subject to periodic remarketing, at which time the interest rates on the reset rate notes are reset. In the event a reset rate note cannot be remarketed on its remarketing date, and is not repurchased, the interest rate generally steps up to and remains at LIBOR plus 0.75 percent, until such time as the bonds are successfully remarketed or refinanced. At September 30, 2009, $210 million of our reset rate notes, representing a single tranche of a single ABS issue, bore interest at LIBOR plus 0.75 percent due to a failed remarketing. Until capital markets conditions improve, it is possible additional reset rate notes will experience failed remarketings. As of September 30, 2009, the Company had $200 million reset rate notes due to be remarketed in 2010 and an additional $235 million to be remarketed in 2014.

NOTE 10 INCOME TAXES

Provision for income taxes

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

	2009	2008
Current:		
Federal	$ 4,726	$ 4,052
State	1,500	1,305
	6,226	5,357
Deferred:		
Federal	(20)	(280)
State	(5)	(70)
	(25)	(350)
Total	$ 6,201	$ 5,007

The income tax provision is based on the pre-tax income of NCMS which is $15,203 thousand and $12,255 thousand as of September 30, 2009 and 2008, respectively.

Deferred income taxes

As of September 30, 2009 and 2008, deferred tax assets consist of the following (in thousands):

	2009	2008
Assets:		
Investments	$ 340	$ 25
Accrued liabilities	65	310
Depreciation and amortization	170	215
Net deferred tax assets	$ 575	$ 550

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

Reconciliation of tax rates

	2009	2008
U.S. Federal statutory rate	35.0	35.0%
State taxes, net of federal benefit	6.4	6.4
Other	(0.6)	(0.5)
Effective tax rate	40.8 %	40.9%

NOTE 11 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	2009	2008
Cash paid for interest (in thousands)	$ 132,931	$ 272,689
Cash paid for income taxes (in thousands)	6,116	5,062

NOTE 12 LOAN FINANCING EXPENSES

Loan financing expenses consist of the following (in thousands)	2009	2008
Interest expense	$ 112,648	$ 254,996
Program and commitment fees	58,541	51,110
	$ 171,189	$ 306,106

NOTE 13 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 $817 thousand for the year ended September 30, 2009 and $767 thousand for the year ended September 30, 2008.

NOTE 14 SIGNIFICANT RISKS AND CONCENTRATIONS

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.

Due to the disruption in the credit markets, the Company is currently unable to borrow the funds needed to finance and originate new loans as it has in the past. The Company continues to manage its current loan portfolio.

On September 17, 2009, the House of Representatives passed H.R. 3221, the Student Aid and Fiscal Responsibility Act (“SAFRA”), which would eliminate the FFELP and require that, after July 1, 2010, all new federal student loans be made through the Direct Student Loan Program. The Senate has yet to take up the legislation. In addition to reform included in the House-passed legislation, there are several other reforms that may be considered as the legislation moves forward. These include a possible extension of ECASLA, which expires on July 1, 2010, and the Student Loan Community Proposal, an alternative student loan proposal endorsed by a cross-section of FFELP service providers (including the Company). Management believes if SAFRA is passed, it will have minimal effect on the Company in the near term because it will continue to service the loans in the T.H.E. program and will provide other services to third parties.

See also Note 8 for loans held as collateral on the bank lines of credit.

NOTE 15 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. These derivative instruments are usually put in place to protect holders of the Company's debt instruments (See Note 9) against specific stress case scenarios assumed by the rating agencies as they model different cash flow scenarios.

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.

Fixed Rate to Floating Rate Derivative Product Agreement

During 2006 the Company entered into a fixed to floating rate derivative product agreement with two counterparties which commenced on April 25, 2007. Under this agreement the counterparties pay to the Company on a quarterly basis the fixed amount at an annualized rate of 4.74% and the Company pays the daily average of the 90 day financial commercial paper rate for the quarter, plus 17.9 basis points. Only the net of these two amounts will be exchanged between the companies on a notional amount of $250 million. This agreement terminated on October 27, 2008. This agreement was in place to support the Company's Student Loan Asset Backed Note Series 2005-1 issuance (see Note 9).

Currency Swap Agreements

The Company may enter into one or more currency swap agreements if any of its reset rate notes are reset to a currency other than US dollars. No currency swap agreements are in place at this time.

Summary of derivative financial statement impact

The following table summarizes the notional value of all derivative instruments at September 30, 2009 and 2008, and their impact on earnings for the year then ended (in thousands).

	2009	2008
Notional Values		
Fixed for variable swap	$ -	$ 250,000
Earnings summary		
Total earnings impact	$ 542	$ 2,241

NOTE 16 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	Carrying Amount	Fair Value	Change in Fair Value from Carrying Amount
Earning assets			
Cash and cash equivalents	$ 11,937	$ 11,937	$ -
Loans, net	5,907,509	5,863,945	(43,564)
Interest receivable	305,539	296,070	(9,469)
Receivable from Great Lakes	13,333	13,333	-
Restricted cash and cash equivalents	181,039	181,039	-

Non-interest and interest-bearing liabilities			
Accounts payable and accrued liabilities	21,461	21,461	-
Government payable	26,429	26,429	-
Accrued salaries and benefits	1,612	1,612	-
Contract servicer payable	458	458	-
Draw against bank line of credit	1,988,609	1,988,609	-
Long-term debt	4,324,909	4,324,909	-

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 estimate of fair value of loans pledged to warehouse financings are based on portfolio valuation rates calculated by warehouse provider. Loans pledged to asset backed bonds are based on values derived by third party calculations of net present value of future cash flows. All other loans are shown at par value.

Interest receivable**:** Interest receivable is based on the fair value of the underlying loans listed above.

Receivables: The carrying amount approximates fair value due to the short maturity of these receivable amounts.

Restricted cash and cash equivalents: The carrying amount of restricted cash and cash equivalents 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.

Government payable: The carrying amount approximates fair value due to the short maturity of this liability.

Draw against bank lines of credit: The carrying amount approximates fair value due to the short-term maturity and frequency of interest rate repricing structured in the financing arrangement.

Long-term debt: The carrying amount approximates fair value due to the frequency of interest rate repricing structured in the financing arrangement.

NOTE 17 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, 2012. The second facility is under a non-cancelable operating lease that expires September 30, 2010.

Future minimum operating lease payments as of September 30, 2009 are (in thousands):

2010	$ 554
2011	480
2012	492
2013	124
Total	$ 1,650

Donations and grants

NEF has committed to provide donations and grants to various organizations totaling $48 thousand through September 30, 2009. Since funds won't be transferred to these organizations without making certain benchmarks agreed upon in advance, no liability has been recorded since these are not unconditional promises to give.

Litigation

The Company is a defendant in four similar putative nationwide class action cases which allege that the Company's suspension of the "bonus" benefit of its student loans in February 2008 was unlawful. This bonus benefit, in brief, had the effect of reducing qualified borrowers' interest expense and, thus, lowering borrowers' loan payments. The Company suspended the bonus because of adverse financial market conditions and maintains that the suspension was lawful in all respects and consistent with the terms and conditions of the student loan programs in which the plaintiffs participate.

The first action, filed July 14, 2008 in the Central District of California, is styled *Jennifer So v. Northstar Education Finance, Inc.*, Case No. CV08-04580 R (FFM). Plaintiff, on behalf of a putative nationwide class of student loan borrowers, alleges that the Company's decision to suspend the bonus was a breach of the student loan contracts. Plaintiff also seeks declaratory and injunctive relief.

The second action, filed August 5, 2008 in the District of Minnesota, is styled *John M. Guidos and John J. Guidos v. Northstar Education Finance, Inc. d/b/a Total Higher Education,* Case No. 0:08-cv-4837 (DWF/JJK). As in the *So* action, plaintiffs, on behalf of a putative nationwide class of student loan borrowers, allege that the Company's suspension of the bonus was a breach of the student loan contracts and also seek injunctive relief (though not declaratory relief). Plaintiffs further allege that the bonus suspension violated the Minnesota Uniform Deceptive Trade Practices Act and the Minnesota Prevention of Consumer Fraud Act.

The third action, filed September 10, 2008 in the Eastern District of Michigan, is styled *Jeffrey Pintar v. Northstar Education Finance, d/b/a Total Higher Education*, Case No. 2:08-cv-13895-JF-DAS. The *Pintar* action is similar to the *So* action, in that plaintiff, on behalf of a putative nationwide class of student loan borrowers, alleges that the Company's suspension of the bonus was a breach of the student loan contracts and also seeks injunctive and declaratory relief.

On November 20, 2008, the Judicial Panel on Multidistrict Litigation ("JPML") heard argument on motions brought by the *Guidos* and *Pintar* plaintiffs to transfer these three similar actions to one federal court in order to coordinate pretrial proceedings. The Company joined in these motions to transfer and further argued that the actions should be transferred to the District of Minnesota. By Order filed December 3, 2008, the JPML ordered that the *So* and *Pintar* actions be transferred to the District of Minnesota for coordinated or consolidated pretrial proceedings with the *Guidos* action pending in Minnesota.

The fourth action, *Staul v. Northstar Education Finance, Inc.*, Case No. 08-cv-06375 (D. Minn.), alleges breach of contract claims based on the Company's suspension of its T.H.E. bonus program.

All four actions were consolidated by the United States Judicial Panel on Multidistrict Litigation, under the caption *In Re Northstar Education Finance, Inc., Contract Litigation*, MDL 1990, on December 3, 2008.

The Company and the Plaintiffs have entered into a Stipulation of Class Action Settlement on December 14, 2009, which was preliminarily approved by the Court. A hearing to consider final approval of the settlement is scheduled for April 8, 2010.

The Company has insurance that could lead to a recovery of the accrued loss or a part thereof. The Company's insurance carriers have so far refused to contribute to the settlement.

The Company has recorded the present value of the mandatory payments in other liabilities of approximately $5.2 million as it anticipates mandatory payments according to the following table if the settlement is approved:

Fiscal Year	Payment
2010	$4,537,500
2011	$ 250,000
2012	$ 250,000
2013	$ 250,000
2014	$ 250,000

The Company will also be required to reinstate its borrower benefit program, under the terms and conditions set forth in the Settlement Agreement as feasible subject to requirements of its financing covenants.

NOTE 18 SUBSEQUENT EVENT

Management has evaluated subsequent events through January 4, 2010, the date which the financial statements were available to be issued. During November 2009, NCMS was selected for audit by the United States Internal Revenue Service for the year ended September 30, 2008. Management is currently unaware of any adjustments to the tax return under audit.