NORTHSTAR EDUCATION FINANCE, INC.
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 and 2009

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BAUNE DOSEN

CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS & PERSONAL CONSULTANTS

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, 2010 and 2009 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, 2010 and 2009, 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 28, 2011
Minneapolis, Minnesota

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
September 30, 2010 and 2009
(in thousands)

	2010	2009
Assets		
Cash and cash equivalents (Note 2)	$ 25,802	$ 11,937
Loans, net (Notes 2, 5, and 6)	5,596,336	5,907,509
Interest receivable	230,699	305,539
Accounts receivable	-	2,380
Receivable from Great Lakes (Note 2)	24,287	13,333
Restricted cash and cash equivalents (Notes 2 and 3)	162,971	181,039
Investment securities (Notes 2 and 4)	-	5,984
Amortizable assets, net (Note 2)	12,007	13,667
Other assets	96	924
Property and equipment, net	-	275
Total assets	$ 6,052,198	$ 6,442,587
Liabilities and net assets		
Accounts payable and accrued liabilities	$ 19,262	$ 21,461
Government payable (Note 2)	21,723	26,429
Accrued salaries and benefits	-	1,612
Contract servicer payable	-	458
Escrow payable (Note 2)	5,364	-
Contingent gain (Note 7)	3,545	-
Income taxes payable	-	710
Draw against bank lines of credit (Note 8)	1,777,062	1,988,609
Long-term debt (Note 9)	4,097,629	4,324,909
Total liabilities	5,924,585	6,364,188
Net assets		
Net assets - unrestricted	127,613	74,194
Non-controlling interests	-	4,205
Total net assets	127,613	78,399
Total liabilities and net assets	$ 6,052,198	$ 6,442,587

See accompanying notes to consolidated financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ACTIVITIES
For The Years Ended September 30, 2010 and 2009
(in thousands)

	2010	2009
Income		
Loan interest income (Note 2)	$ 151,500	$ 221,035
Servicing revenue	5,273	8,348
Total income	156,773	229,383
Expenses		
Loan financing expenses (Note 12)	87,459	171,189
T.H.E. bonus expense	360	3,369
Provision for loan losses	7,271	4,505
Amortization	1,660	1,642
Salaries and benefits	8,761	10,556
Professional services	1,415	3,196
Promotion and marketing	3	3
Donations and grants	48	388
Other	3,400	3,156
Total expenses	110,377	198,004
Change in net assets before other income	46,396	31,379
Other income		
Other revenue	458	977
Other expense	(1,299)	-
Gain on sale (Note 7)	14,715	-
Derivative market value adjustment (Note 15)	-	542
Interest income	973	1,994
Total other income	14,847	3,513
Change in net assets before income tax provision and non - controlling interests	61,243	34,892
Provision for income taxes (Note 10)	(5,022)	(6,201)
Change in net assets attributable to non-controlling interests	(2,802)	(3,989)
Change in net assets	53,419	24,702
Net assets, beginning of period	74,194	49,492
Net assets, end of period	$ 127,613	$ 74,194

See accompanying notes to consolidated financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended September 30, 2010 and 2009
(in thousands)

	2010	2009
Cash flows from operating activities		
Change in net assets	$ 53,419	$ 24,702
Adjustments to reconcile change in net assets to cash flows from operating activities:		
Amortization	1,660	1,642
Depreciation	146	210
Provision for loan losses	7,271	4,505
Loan premium expense	12,717	4,123
Gain on sale	(14,715)	-
Investment impairment	850	612
(Increase) decrease in assets:		
Interest receivable	74,840	(16,100)
Accounts receivable	2,380	462
Receivable from Great Lakes	(10,954)	(2,678)
Government receivable	-	9,761
Other assets	828	(151)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(2,199)	(21,011)
Government payable	(4,706)	22,057
Accrued salaries and benefits	(1,612)	(69)
Contract servicer payable	(458)	(12)
Escrow payable	5,364	-
Contingent gain	3,545	-
Income taxes payable	(710)	110
Net cash flows from operating activities	127,666	28,163
Cash flows from investing activities		
Net change in loans	291,185	356,204
Net change in restricted cash	18,068	68,612
Proceeds from sale of NCMS stock	15,867	-
Disposal of property and equipment under sale	158	-
Purchases of property and equipment	(29)	(70)
Net cash flows from investing activities	325,249	424,746
Cash flows from financing activities		
Payments on government participation payable	-	(87,245)
Net change in draw against bank lines of credit	(211,547)	(157,291)
Payments on long-term debt	(227,280)	(200,805)
Change in non-controlling interests	(223)	(750)
Net cash flows from financing activities	(439,050)	(446,091)
Net increase in cash and cash equivalents	13,865	6,818
Cash and cash equivalents at beginning of year	11,937	5,119
Cash and cash equivalents at end of year	$ 25,802	$ 11,937

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 provide services to other third parties involved in education financial services. Prior to August 30, 2010 (See Note 7), NEF owned 56% of NCMS’s issued and outstanding capital stock and nine members of NCMS's management collectively owned 42%. The remaining 2% of outstanding stock was 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 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, the Company's former subsidiary. NCMS had entered into Master Servicing Agreements with NEF and its limited liability company subsidiaries to provide general management services to 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 Master Servicing Agreements will expire in August 2017.

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 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, 2010 and 2009.

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 consisted entirely of auction rate bonds. NCMS purchased $6.8 million of securities issued by NEF on the open market. See Notes 4 and 7.

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 fully amortized as of September 30, 2010.

Government payable

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

Escrow payable

Escrow payable represents funds held in escrow pursuant to the NCMS Shareholder Disbursement Trust Agreement and the Escrow Agreement that relate to the sale and deconsolidation of NCMS. See Note 7.

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.” The Company does not 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.

In addition, 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 based on a threshold of more-likely than-not for recognition and derecognition of tax positions taken or expected to be taken in a tax return. The Company has no uncertain tax positions meeting the threshold. See Notes 7 and 10.

Principles of consolidation

The consolidated financial statements include the accounts of NEF and its subsidiaries (T.H.E. II, T.H.E. III and NCMS). All significant intercompany transactions have been eliminated in consolidation. See also Note 7.

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.

Reclassifications

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

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. See also Note 7.

NOTE 3 RESTRICTED CASH AND CASH EQUIVALENTS

The components of restricted cash and cash equivalents in the statement of financial position at September 30, 2010 and 2009 are as follows (in thousands):

	2010	2009
Accounts pledged to financings	$ 106,539	$ 135,061
Accounts pledged for liquidity and default reserves	49,633	45,978
Accounts held in escrow for possible transfer to non-controlling interests from sale of subsidiary	2,597	-
Accounts held in escrow for possible future benefit of the Company from sale of subsidiary	4,202	-
Total	$ 162,971	$ 181,039

NOTE 4 INVESTMENT SECURITIES

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

	2010		2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Auction rate securities	$ -	$ -	$ 6,800	$ 5,984

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 changes 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

	2010	2009
Auction rate securities		
Balance, beginning of period	$ 5,984	$ 6,596
Other than temporary investment impairment	(850)	(612)
Disposal, liquidation of investment securities	(5,134)	
Balance, September 30th	$ -	$ 5,984

No gross unrealized gains or losses existed at September 30, 2010 or 2009. See also Note 7.

NOTE 5 LOANS

The components of loans in the statement of financial position at September 30, 2010 and 2009 are as follows (in thousands):

	2010	2009
Federal guaranteed student loans	$ 4,903,373	$5,164,689
Private student loans	593,870	631,030
Unamortized loan premium	117,823	130,669
Loans and refunds in process	54	(131)
Total	5,615,120	5,926,257
Allowance for credit losses	(18,784)	(18,748)
Net loans	$ 5,596,336	$5,907,509

As of September 30, 2010, the Company is not committed to fund any student loans.

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, 2010 and 2009 follows (in thousands):

	2010	2009
Beginning balance	$ 18,748	$ 18,575
Provision for loan losses	7,271	4,505
Charge-offs, net of recoveries	(7,235)	(4,332)
Ending balance	$ 18,784	$ 18,748

At September 30, 2010 loans totaling approximately $49 million were 91 days or more delinquent. Of the total delinquent loans over 91 days approximately $42 million were federal guaranteed student loans and approximately $7 million were private student loans.

NOTE 7 SALE OF INVESTMENT IN SUBSIDIARY

On August 30, 2010, the Company increased its investment in a subsidiary (NCMS) by purchasing an additional 2% interest from a non-controlling interest and simultaneously sold all of its then interests in NCMS to an unrelated party liquidating all of the Company's investment and control in the subsidiary. See Note 1 for additional information on NCMS. Therefore, as of September 30, 2010 the assets and liabilities of NCMS are no longer included in the statement of position while the statement of activities does include the operations or activities of NCMS through the change in control date or approximately eleven months of operations in 2010 compared with twelve months in 2009. Due to the sale of NCMS in 2010, the Company's financial statements, including footnotes between 2010 and 2009, will vary due to this divesture. The Master Servicing Agreements as described in Note 1 between NCMS, NEF and its limited liability company subsidiaries will continue after the sale.

The general terms of the stock sale included a gross sales price of approximately $40 million for all outstanding shares of NCMS. Approximately $6.2 million of these funds are set aside and subject to certain contingent obligations. These funds can not be disbursed until on or after February 28, 2013, subject to written request of the sellers representative. Based on the terms of the agreement, the Company recorded a gain on the sale of approximately $14.7 million and is reported in the statement of activities caption "Gain on sale," with an additional $3.5 million recorded as a contingent gain and reported on the statement of position in the caption "Contingent gain." The Company will not recognize the $3.5 million contingent gain in the statement of activities until such time as certain restrictions are released by the acquirer.

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 0.44% at September 30, 2010) depending on funding sources. These lines granted maximum credit of approximately $1.78 billion and $2 billion at September 30, 2010 and 2009. Amounts outstanding are due on demand, and are secured by student loans. The Company had amounts outstanding of $1.78 billion and $1.99 billion at September 30, 2010 and 2009. 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, 2010 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. See also Note 18 for additional information and development of subsequent events.

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, 2010 and 2009 by issue (in thousands):

Auction Rate Student Loan Asset-Backed Notes	Final Maturity	2010 Carrying Amount	2009 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	1.82-2.28%
Series 2002-B	4/1/2042	37,000	37,000	2.99%
Series 2004-B	12/1/2044	30,000	30,000	1.26%

Auction Rate Student Loan Asset-Backed Notes	Final Maturity	2010 Carrying Amount	2009 Carrying Amount	Interest Rate
Series 2004-2B	2/28/2044	25,500	25,500	1.54%
Series 2005-1B	10/30/2045	20,000	20,000	1.54%
Series 2007-1A	1/29/2046	410,150	410,150	1.75-1.76%
Series 2007-1B	1/28/2047	32,200	32,200	1.59%
Total Auction Rate Securities		797,850	797,850	

Floating Rate Notes Loan Asset-Backed Notes	Final Maturity	2010 Carrying Amount	2009 Carrying Amount	Interest Rate
Series 2004-1A-2	1/28/2014	0	74,000	0.61%
Series 2004-1A-3	4/28/2017	168,000	200,000	0.66%
Series 2004-1A-4	4/29/2019	225,000	225,000	0.68%
Series 2004-2A-1	4/28/2016	212,180	262,675	0.61%
Series 2004-2A-2	1/30/2017	150,000	150,000	0.63%
Series 2004-2A-3	7/30/2018	280,000	280,000	0.66%
Series 2004-2A-4	7/28/2021	249,500	249,500	0.72%
Series 2005-1A-1	10/28/2026	187,100	193,100	0.59%
Series 2005-1A-2	7/28/2027	118,300	118,300	0.62%
Series 2005-1A-3	10/30/2030	227,900	227,900	0.66%
Series 2005-1A-4	4/28/2032	210,700	210,700	0.72%
Series 2006-A1	11/30/2020	0	347	0.34%
Series 2006-A2	11/28/2023	72,552	111,290	0.49%
Series 2006-A3	5/28/2026	112,931	112,931	0.51%
Series 2006-A4	8/28/2035	208,056	208,056	0.65%
Series 2006-B1	11/28/2035	65,260	65,260	0.85%
Series 2007-1A-1	4/28/2030	193,000	193,000	0.59%
Series 2007-1A-2	1/29/2046	200,000	200,000	1.24%
Series 2007-1A-3	1/29/2046	235,000	235,000	0.55%
Total Floating Rate Notes		3,115,479	3,317,059	

Fixed Rate Notes Loan Asset-Backed Notes	Final Maturity	2010 Carrying Amount	2009 Carrying Amount	Interest Rate
Series 2005-1A-5	10/30/2045	184,300	210,000	1.25%
Total Long-term Debt		$4,097,629	$ 4,324,909	

The following is a schedule of anticipated long-term debt principal reductions as of September 30, 2010 (in thousands):

2011	$ 207,095
2012	208,844
2013	212,761
2014	213,233
2015	202,270
Remainder	3,053,426
Total	$4,097,629

At September 30, 2010, the Company held $798 million of taxable auction rate securities. However, 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 the Company's auction rate securities' interest rates are set. Because of this disruption, all of the Company's auction rate securities bore interest at the maximum rate allowable under their terms. The maximum allowable interest rate on the $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. As of September 30, 2010, $384 million of our reset rate notes, representing two tranches of ABS, bore interest at LIBOR plus 0.75 percent due to failed remarketing. Until capital market conditions improve, it is possible additional reset rate notes will experience failed remarketing. As of September 30, 2010, the Company had $235 million reset rate notes due to be remarketed in 2014.

NOTE 10 INCOME TAXES

Provision for income taxes

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

	2010	2009
Current:		
Federal	$ 3,921	$ 4,726
State	1,251	1,500
	5,172	6,226
Deferred:		
Federal	(115)	(20)
State	(35)	(5)
	(150)	(25)
Total	$ 5,022	$ 6,201

The income tax provision is based on the pre-tax income of NCMS which is approximately $11,346 thousand and $15,203 thousand as of August 31, 2010 and September 30, 2009, respectively due to the sale of NCMS. See also Note 7.

Deferred income taxes

No deferred tax assets or liabilities existed as of September 30, 2010 as discussed in Note 7, however, as of September 30, 2009, the deferred tax assets consist of the following (in thousands):

	2009
Assets:	
Investments	$ 340
Accrued liabilities	65
Depreciation and amortization	170
Net deferred tax assets	$ 575

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

Reconciliation of tax rates

	2010	2009
U.S. Federal statutory rate	35.0%	35.0%
State taxes, net of federal benefit	6.4	6.4
Other	2.9	(0.6)
Effective tax rate	44.3 %	40.8%

NOTE 11 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	2010	2009
Cash paid for interest (in thousands)	$ 37,053	$ 132,931
Cash paid for income taxes (in thousands)	5,732	6,116

Non-cash investment and financing activities (in thousands):

Investments distributed as dividends	5,134	-

NOTE 12 LOAN FINANCING EXPENSES

Loan financing expenses consist of the following (in thousands)	2010	2009
Interest expense	$ 36,991	$ 112,648
Program and commitment fees	50,468	58,541
	$ 87,459	$ 171,189

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 $727 thousand for the year ended September 30, 2010 and $817 thousand for the year ended September 30, 2009.

NOTE 14 SIGNIFICANT RISKS AND CONCENTRATIONS

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

The Company holds student loans from students throughout the United States. The Company's private loans are 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”). On March 30, 2010, President Obama signed into law H.R. 4872, the Health Care and Education Reconciliation Act of 2010 (“HCERA”), which included the SAFRA Act. Effective July 1, 2010, the legislation eliminated the authority to provide new loans under FFELP and requires that all new federal loans are to be made through the Direct Student Loan Program (“DSLP”). The new law does not alter or affect the terms and conditions of existing FFELP loans.

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

In 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

No currency swap agreements are in place as of September 30, 2010.

Summary of derivative financial statement impact

The following table summarizes the notional value of all derivative instruments at September 30, 2010 and 2009, and their impact on earnings for the year then ended (in thousands).

	2010	2009
Notional Values		
Fixed for variable swap	$ -	$ -
Earnings summary		
Total earnings impact	$ -	$ 542

NOTE 16 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	2010		2009	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 25,802	$ 25,802	$ 11,937	$ 11,937
Loans, net	5,596,336	5,563,306	5,907,509	5,863,945
Interest receivable	230,699	222,537	305,539	296,070
Receivable from Great Lakes	24,287	24,287	13,333	13,333
Restricted cash and cash equivalents	162,971	162,971	181,039	181,039
Financial liabilities				
Accounts payable and accrued liabilities	19,262	19,262	21,461	21,461
Government payable	21,723	21,723	26,429	26,429
Draw against bank line of credit	1,777,062	1,777,062	1,988,609	1,988,609
Long-term debt	4,097,629	4,097,629	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 expired September 30, 2010.

Future minimum operating lease payments as of September 30, 2010 are (in thousands):

2011	$ 480
2012	492
2013	124
Total	$ 1,096

Donations and grants

As of September 30, 2010, NEF has no outstanding commitments to provide donations or grants to organizations.

Litigation

Bonus Suspension Litigation

The Company was a defendant in four similar putative nationwide class action cases which alleged that the Company's suspension of the "bonus" benefit of its student loans in February 2008 was unlawful. 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 No. 1990 in the United States District Court for Minnesota on December 3, 2008.

Following consolidation, the Company entered into settlement negotiations with counsel for the plaintiffs in the MDL action. The Company and counsel for the plaintiffs negotiated a Stipulation for Class Action Settlement (the "Settlement"), the Settlement was preliminarily approved by the Court on December 21, 2009, notice of the Settlement was transmitted to all class members, and final approval of the Settlement was received on April 8, 2010. The time for an appeal of the final approval of the Settlement expired on May 10, 2010, without appeal. Accordingly, these claims have been resolved.

The Company recorded the present value of the mandatory payments pursuant to the Settlement Agreement in other liabilities of approximately $5.2 million in 2009 and paid approximately $4.9 million during the year ended September 30, 2010. The remaining minimum payments are shown in the following table (in thousands):

Fiscal Year	Mandatory Legal Payments	Minimum T.H.E. Bonus Payments	Total Payments
2011	$ -	$ 1,250	$ 1,250
2012	250	1,250	1,500
2013	250	1,250	1,500
2014	250	1,250	1,500
2015	250	1,250	1,500

The Company was also 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 and borrower eligibility. T.H.E. Bonus Payments or borrower benefits are accrued and expensed as earned in the appropriate period incurred.

Coverage Action

In *Northstar Education Finance, Inc. v. St. Paul Mercury Insurance Company and Philadelphia Indemnity Insurance Company* ("Coverage Action"), the Company filed suit against St. Paul Mercury Insurance Company ("St. Paul"), its primary liability insurer, and Philadelphia Indemnity Insurance Company ("Philadelphia"), its umbrella liability insurer, seeking to recover from its liability insurers amounts which the Company has paid or will pay in a settlement of underlying litigation captioned *In Re Northstar Education Finance, Inc. Contract Litigation*, described above ("Underlying Action"). The Coverage Action, pending in Ramsey County, Minnesota, state district court, seeks both monetary recovery from the Company's insurers of sums which the Company has already paid, and declaratory relief declaring the insurers obligated to reimburse the Company for the Company's future payment obligations, in the settlement of the Underlying Action. The Coverage Action also seeks to recover some defense costs incurred in the Underlying Action which remain unreimbursed by the Company's primary insurer, St. Paul. Philadelphia has answered and denied any liability to the Company under its umbrella policy. St. Paul has answered, has denied any liability to the Company under its primary policy, and has filed a counterclaim seeking recovery of defense cost reimbursement payments which St. Paul has already made with respect to the Company's costs of defending the Underlying Action. St. Paul could recover on its counterclaim up to the amount which St. Paul has paid to the Company in reimbursement of defense costs incurred in the Underlying Action. The Coverage Action is in the early stages, and we are unable to determine the likelihood of success on the claims against St. Paul and Philadelphia, or St. Paul's counterclaim against the Company or on the amount or range of potential liability, if any.

NOTE 18 SUBSEQUENT EVENTS

By letter dated November 10, 2010 one of the banks providing a line of credit to the Company's subsidiary, T.H.E. II, informed the Company that if it did not market the student loan collateral that partially secured the line of credit for sale to third parties it would exercise its rights to foreclose on the collateral securing the line of credit. Subsequently, on December 30, 2010, NEF sold approximately $483 million of federally insured student loans to an unrelated third party. Proceeds of the loan sale and other Company funds were then used to repay a portion of the outstanding line of credit. The outstanding balance of the line of credit related to the Company's subsidiary, T.H.E. II, decreased from $505 million to approximately $10.8 million as a result of this transaction. Management anticipates that T.H.E. II will be dissolved once the line of credit has been paid in full. Management is currently considering other loan liquidation options with the Company's private student loan portfolio to resolve the remaining outstanding balance.

Management has evaluated subsequent events through January 28, 2011, the date which the financial statements were available to be issued.