NORTHSTAR EDUCATION FINANCE, INC.
AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2011 and 2010

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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, 2011 and 2010 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 audits.

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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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, 2011 and 2010, 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 27, 2012
Minneapolis, Minnesota

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
September 30, 2011 and 2010
(in thousands)

	2011	2010
Assets		
Cash and cash equivalents (Note 2)	$ 17,510	$ 25,802
Loans, net (Notes 2, 4, and 5)	4,800,481	5,596,336
Interest receivable	135,934	230,699
Receivable from Great Lakes (Note 2)	14,554	24,287
Restricted cash and cash equivalents (Notes 2 and 3)	135,568	162,971
Amortizable assets, net (Note 2)	11,300	12,007
Other assets	-	96
Total assets	$ 5,115,347	$ 6,052,198
Liabilities and net assets		
Accounts payable and accrued liabilities	$ 12,159	$ 19,262
Government payable (Note 2)	14,985	21,723
Escrow payable (Note 2)	1,991	5,364
Contingent gain (Note 6)	2,312	3,545
Draw against bank lines of credit (Note 7)	1,085,720	1,777,062
Long-term debt (Note 8)	3,837,029	4,097,629
Total liabilities	4,954,196	5,924,585
Net assets		
Net assets - unrestricted	161,151	127,613
Total liabilities and net assets	$ 5,115,347	$ 6,052,198

See accompanying notes to consolidated financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ACTIVITIES
For The Years Ended September 30, 2011 and 2010
(in thousands)

	2011	2010
Income		
Loan interest income (Note 2)	$ 125,543	$ 151,500
Servicing revenue	-	5,273
Total income	125,543	156,773
Expenses		
Loan financing expenses (Note 12)	101,888	87,459
T.H.E. bonus expense	1,490	360
Provision for loan losses	3,626	7,271
Federal loan default expense	512	481
Amortization	1,128	1,660
Salaries and benefits	22	8,781
Professional services	1,122	1,415
Promotion and marketing	-	3
Donations and grants	-	48
Other	1	2,899
Total expenses	109,789	110,377
Change in net assets before other income	15,754	46,396
Other income		
Other revenue (Note 2)	4,059	458
Other expense	-	(1,299)
Gain on sale (Note 6)	2,911	14,715
Gain on sale of loans (Note 10)	4,066	-
Debt forgiveness (Note 10)	5,582	-
Interest income	1,166	973
Total other income	17,784	14,847
Change in net assets before income tax provision and non - controlling interests	33,538	61,243
Provision for income taxes (Notes 2 and 9)	-	(5,022)
Change in net assets attributable to non-controlling interests	-	(2,802)
Change in net assets	33,538	53,419
Net assets, beginning of period	127,613	74,194
Net assets, end of period	$ 161,151	$ 127,613

See accompanying notes to consolidated financial statements.

NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended September 30, 2011 and 2010
(in thousands)

	2011	2010
Cash flows from operating activities		
Change in net assets	$ 33,538	$ 53,419
Adjustments to reconcile change in net assets to cash flows from operating activities:		
Amortization	1,128	1,660
Depreciation	-	146
Provision for loan losses	3,239	7,271
Loan premium expense	20,333	12,717
Gain on sale	-	(14,715)
Investment impairment	-	850
(Increase) decrease in assets:		
Interest receivable	94,765	74,840
Accounts receivable	-	2,380
Receivable from Great Lakes	9,733	(10,954)
Other assets	96	828
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(7,103)	(2,199)
Government payable	(6,738)	(4,706)
Accrued salaries and benefits	-	(1,612)
Contract servicer payable	-	(458)
Escrow payable	(3,373)	5,364
Contingent gain	(1,233)	3,545
Income taxes payable	-	(710)
Net cash flows from operating activities	144,385	127,666
Cash flows from investing activities		
Net change in loans	772,283	291,185
Net change in restricted cash	27,403	18,068
Proceeds from sale of NCMS stock	-	15,867
Disposal of property and equipment under sale	-	158
Purchases of property and equipment	-	(29)
Net cash flows from investing activities	799,686	325,249
Cash flows from financing activities		
Net change in draw against bank lines of credit	(691,342)	(211,547)
Payments on long-term debt	(260,600)	(227,280)
Financing costs	(421)	-
Change in non-controlling interests	-	(223)
Net cash flows used in financing activities	(952,363)	(439,050)
Net increase (decrease) in cash and cash equivalents	(8,292)	13,865
Cash and cash equivalents at beginning of year	25,802	11,937
Cash and cash equivalents at end of year	$ 17,510	$ 25,802

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 of 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 6), 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 entered into a Master Servicing Agreement with NEF 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 Agreement 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 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 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.

Federal student loans are guaranteed by the Department of Education ranging from 97% to 100% of principal and related interest balances. Due to management's historical experience with these loan types and the guarantee, no provision for federal student loan losses has been provided for by management in the consolidated financial statements.

The Company's allowance for credit losses represents a reserve for the estimated losses on the Company's private student loans. Management evaluates the allowance for private student loans on a quarterly basis to ensure the reserve is adequate to reflect any potential losses incurred. Management considers the overall risk profile of its private loans including volume and type of loans, delinquencies, non-performing loans including those in forbearance, and charge-off experiences using a static pool migration analysis. In addition, management considers uncertainties related to loan concentrations and general economic conditions. Losses on private loans are charged against the allowance when the loans default and recovery of amounts charged off are credited to the allowance for credit losses.

Management believes the allowance for credit losses is adequate as of September 30, 2011 and 2010. While management used available information to estimate losses on private 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 these 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, 2011 and 2010.

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. The indenture trustee may withdraw funds from certain restricted cash accounts when federal and private loans are 180 days or more delinquent. 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. The financing costs are amortized over the principal life of the corresponding debt.

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.

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 6.

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 2010 consolidated financial statements for NCMS, its for-profit business subsidiary.

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. Federal returns for the tax years ended 2007, 2008, 2009 and 2010 remain subject to examination by the Internal Revenue Service. See also Note 9.

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 6.

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.

Other revenue

Other revenue consists primarily of a payment received as part of a settlement with the Wisconsin Insurance Commissioner on an Ambac Assurance Policy for the year ended September 30, 2011.

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 consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3 RESTRICTED CASH AND CASH EQUIVALENTS

The components of restricted cash and cash equivalents in the consolidated statements of financial position at September 30, 2011 and 2010 are as follows (in thousands):

	2011	2010
Accounts pledged to financings	$ 87,233	$ 106,539
Accounts pledged for liquidity and default reserves	44,028	49,633
Accounts held in escrow for possible transfer to non-controlling interests from sale of subsidiary	301	2,597
Accounts held in escrow for possible future benefit of the Company from sale of subsidiary	4,006	4,202
Total	$ 135,568	$ 162,971

NOTE 4 LOANS

The components of loans in the consolidated statements of financial position at September 30, 2011 and 2010 are as follows (in thousands):

	2011	2010
Federal guaranteed student loans	$ 4,165,851	$ 4,903,373
Private student loans	553,688	593,870
Unamortized loan premium	97,135	117,823
Loans and refunds in process	(44)	54
Total	4,816,630	5,615,120
Allowance for credit losses	(16,149)	(18,784)
Net loans	$ 4,800,481	$5,596,336

As of September 30, 2011 and 2010, the Company was not committed to fund any student loans.

NOTE 5 ALLOWANCE FOR CREDIT LOSSES

Analysis of the change in the allowance for credit losses on private loans for the year ended September 30, 2011 and 2010 is as follows (in thousands):

	2011	2010
Beginning balance	$ 18,784	$ 18,748
Provision for loan losses	3,626	7,271
Charge-offs, net of recoveries	(6,261)	(7,235)
Ending balance	$ 16,149	$ 18,784

At September 30, 2011, loans totaling approximately $54 million were 91 days or more delinquent. Of the total delinquent loans over 91 days, approximately $48 million were federal guaranteed student loans and approximately $6 million were private student loans.

NOTE 6 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 selling 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 consolidated statement of position while the consolidated 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. Due to the sale of NCMS in 2010, the Company's consolidated financial statements, including footnotes between 2011 and 2010, will vary due to this divesture.

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 cannot 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 consolidated statement of activities caption "Gain on sale," with an additional $3.5 million recorded as a contingent gain and reported on the September 30, 2010 consolidated statement of position in the caption "Contingent gain", to be recognized when certain restrictions are released by the acquirer.

During the year ended September 30, 2011, certain restrictions were met and approximately $1.2 million was paid out on the contingent gain to the Company and was recorded as “Gain on sale.” Approximately $900 thousand was paid to the former non-controlling interests.

The loan sales disclosed in Note 10 triggered additional payments to the sellers pursuant to the stock sale agreement. The Company received approximately $1.7 million during the year ended September 30, 2011 and was recorded as “Gain on sale”.

NOTE 7 DRAW AGAINST BANK LINES OF CREDIT

The Company had four lines of credit with interest at varying rates (interest rates were 0.20% to 4.24% at September 30, 2011) depending on funding sources. During the year ended September 30, 2011, one line of credit was paid down and forgiven (see Note 10). These lines granted maximum credit of approximately $1.09 billion and $1.78 billion at September 30, 2011 and 2010, respectively. Amounts outstanding are due on demand and are secured by student loans. The Company had amounts outstanding of $1.09 billion and $1.78 billion at September 30, 2011 and 2010, respectively. In connection with the line of credit agreements, 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, 2011, 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 received a waiver of covenant violations until September 25, 2012 on one line of credit totaling $306 million as of September 30, 2011.

NOTE 8 LONG-TERM DEBT

The Company periodically issued 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 issued 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 issued 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, 2011 and 2010 by issue (in thousands):

Auction Rate Student Loan Asset-Backed Notes	Final Maturity	2011 Carrying Amount	2010 Carrying Amount	Interest Rate
Series 2000-B	11/1/2040	$ 9,500	$ 9,500	2.34%
Series 2002	4/1/2042	233,500	233,500	1.53-2.13%
Series 2002-B	4/1/2042	37,000	37,000	2.88%
Series 2004-B	12/1/2044	30,000	30,000	1.23%
Series 2004-2B	2/28/2044	25,500	25,500	1.39%
Series 2005-1B	10/30/2045	20,000	20,000	1.39%
Series 2007-1A	1/29/2046	410,150	410,150	1.60-1.62%
Series 2007-1B	1/28/2047	32,200	32,200	1.44%
Total Auction Rate Securities		797,850	797,850	

Floating Rate Notes Loan Asset-Backed Notes	Final Maturity	2011 Carrying Amount	2010 Carrying Amount	Interest Rate
Series 2004-1A-3	4/28/2017	49,000	168,000	0.42%
Series 2004-1A-4	4/29/2019	225,000	225,000	0.44%
Series 2004-2A-1	4/28/2016	170,385	212,180	0.37%
Series 2004-2A-2	1/30/2017	150,000	150,000	0.39%
Series 2004-2A-3	7/30/2018	280,000	280,000	0.42%
Series 2004-2A-4	7/28/2021	249,500	249,500	0.48%
Series 2005-1A-1	10/28/2026	147,800	187,100	0.35%
Series 2005-1A-2	7/28/2027	118,300	118,300	0.38%
Series 2005-1A-3	10/30/2030	227,900	227,900	0.42%
Series 2005-1A-4	4/28/2032	210,700	210,700	0.48%
Series 2006-A2	11/28/2023	31,547	72,552	0.51%
Series 2006-A3	5/28/2026	112,931	112,931	0.53%
Series 2006-A4	8/28/2035	208,056	208,056	0.67%
Series 2006-B1	11/28/2035	65,260	65,260	0.87%
Series 2007-1A-1	4/28/2030	193,000	193,000	0.35%
Series 2007-1A-2	1/29/2046	200,000	200,000	1.00%
Series 2007-1A-3	1/29/2046	235,000	235,000	0.31%
Total Floating Rate Notes		2,874,379	3,115,479	

Fixed Rate Notes Loan Asset-Backed Notes	Final Maturity	2011 Carrying Amount	2010 Carrying Amount	Interest Rate
Series 2005-1A-5	10/30/2045	164,800	184,300	1.00%
Total long-term debt		$ 3,837,029	$ 4,097,629	

The following is a schedule of anticipated long-term debt principal reductions as of September 30, 2011 (in thousands):

2012	$ 208,844
2013	212,761
2014	213,233
2015	202,270
2016	185,870
Remainder	2,814,051
Total	$3,837,029

At September 30, 2011, 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, 2011 and 2010, $365 million and $384 million, respectively, of our reset rate notes, representing two tranches of asset-backed securities, 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, 2011, the Company had $235 million reset rate notes due to be remarketed in 2014.

NOTE 9 INCOME TAXES

Provision for income taxes

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

	2010
Current:	
Federal	$ 3,921
State	1,251
	5,172
Deferred:	
Federal	(115)
State	(35)
	(150)
Total	$ 5,022

The provision for income taxes is based on the pre-tax income of NCMS which is approximately $11.3 million as of August 31, 2010, due to the sale of NCMS. See also Note 6.

Reconciliation of tax rates

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

NOTE 10 LOAN SALE AND REFINANCE

On December 30, 2010, NEF sold approximately $475 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.

On May 25, 2011, NEF obtained a $18.7 million line of credit and used $8.5 million to refinance the remaining private student loan portfolio. A portion of the balance remaining on the T.H.E. II line of credit was paid and the remaining amount was forgiven by the lender.

These two transactions resulted in a gain on sale of loans totaling approximately $4 million and debt forgiveness of approximately $5.6 million.

NOTE 11 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	2011	2010
Cash paid for interest (in thousands)	$ 34,610	$ 37,053
Cash paid for income taxes (in thousands)	-	5,732

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):	2011	2010
Interest expense	$ 32,799	$ 36,991
Program and commitment fees	69,089	50,468
	$ 101,888	$ 87,459

For the year ended September 30, 2011, program and commitment fees include a $1.6 million payment to NCMS for restructing the debt on T.H.E. II and an approximate payment of $6.7 million to compensate NCMS for lost revenue as a result of selling loans out of T.H.E. II. See also Note 10.

NOTE 13 EMPLOYEE BENEFITS

During 2010, NCMS had a 401(k) defined contribution plan for employees who had attained age 19 and completed three months of service. Plan benefits were 100% vested at the completion of three years of service. Prior to the completion of three years of service, vesting was graduated. Employees could contribute up to the maximum percentage allowable not to exceed the limits of Code Sections 401(k), 404 and 415. NCMS matched employee contributions on a discretionary basis. In addition, NCMS could 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. See Note 6 for additional information of NCMS.

NOTE 14 SIGNIFICANT RISKS AND CONCENTRATIONS

The Company receives periodic payments from their primary contract loan servicer. These amounts are generally unsecured in between the time student loan payments are received by the contract servicer and the time they are remitted to the Company.

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 conditions.

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. Because of this and the disruption in the credit markets, the Company continues to manage its current loan portfolio and is unable to originate both new federal and private student loans.

See also Note 7 for loans held as collateral on the bank lines of credit.

NOTE 15 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	2011		2010	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 17,510	$ 17,510	$ 25,802	$ 25,802
Loans, net	4,800,481	4,774,919	5,596,336	5,563,306
Interest receivable	135,934	131,346	230,699	222,537
Receivable from Great Lakes	14,554	14,554	24,287	24,287
Restricted cash and cash equivalents	135,568	135,568	162,971	162,971
Financial liabilities				
Accounts payable and accrued liabilities	12,159	12,159	19,262	19,262
Government payable	14,985	14,985	21,723	21,723
Draw against bank lines of credit	1,085,720	1,085,720	1,777,062	1,777,062
Long-term debt	3,837,029	3,837,029	4,097,629	4,097,629

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 providers. 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.

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

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 arrangements.

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

NOTE 16 COMMITMENTS AND CONTINGENCIES

Donations and grants

As of September 30, 2011 and 2010, NEF had no outstanding commitments to provide donations or grants to organizations.

Asserted claims

Bonus Suspension Litigation

The Company was a defendant in four similar 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 $1.5 million and $4.9 million during the years ended September 30, 2011 and 2010, respectively. 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
2012	$ 470	$ 1,250	$ 1,720
2013	250	1,250	1,500
2014	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, filed in Ramsey County, Minnesota, state district court, sought 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 sought to recover some defense costs incurred in the Underlying Action which remain unreimbursed by the Company's primary insurer, St. Paul. Philadelphia answered and denied any liability to the Company under its umbrella policy. St. Paul answered, denied any liability to the Company under its primary policy, and 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. The matter was submitted to the district court on cross-motions for summary judgment. The district court issued an order dismissing the Company's claims, and granting St. Paul's claim to recover the amount which St. Paul paid to the Company in reimbursement of defense costs incurred in the Underlying Action. Judgment has not yet been entered, but entry of judgment against the Company in the amount of $269 thousand plus interest and costs has been ordered. The time within which to appeal that order has not yet passed. Management has accrued the judgment liability totaling $269 thousand.

Unasserted claims

NCMS Claim for Indemnification for Certain Tax Liabilities Under July 31, 2010 Stock Purchase Agreement

On November 15, 2011, NCMS provided written notice and an analysis of estimated losses totaling approximately $485 thousand to the Company of its intent to seek indemnification for certain tax liabilities that are alleged to be the Sellers' (NEF and other non-controlling interests) responsibility under the terms of the Stock Purchase Agreement. The Company conducted its own analysis and a counter amount has been presented to NCMS. The Company and NCMS are in the process of negotiating the amount of the loss. Although the ultimate outcome of this matter cannot be predicted with certainty, the Company believes it will be less than the initial amount. As of the date of these consolidated financial statements, a range of possible losses cannot be reasonably estimated. When the loss can be reasonably estimated, the loss amount will reduce the restricted cash and contingent gain on the consolidated statement of financial position. See also Note 6.

NCMS/Customer Claim for Indemnification for Alleged TILA Liabilities (under July 31, 2010 Stock Purchase Agreement)

In June 2011, NCMS received notification from a current customer ("Customer") that it was reserving the right to make a claim for faulty software programming. NCMS provided written notice to the Company of NCMS's intent to seek indemnification for these claims made by Customer against NCMS allegedly arising out of activities that are claimed to have begun prior to the closing of the Stock Purchase Agreement. No claim has been filed by Customer and the outcome of this matter cannot be predicted with certainty.

NOTE 17 SUBSEQUENT EVENTS

In January 2012, the DOE announced a short-term consolidation opportunity (*Special Direct Consolidation Loan Program)*, ending June 30, 2012, which is intended to help borrowers manage their debt by ensuring all of their federal loans are serviced by the same entity, resulting in one bill and one payment. Borrowers will also receive an interest rate reduction on Special Direct Consolidation Loans as a repayment incentive. To qualify for a Direct Consolidation Loan, borrowers must have at least one Direct Loan or Federal Family Education Loan (FFEL) that is in grace, repayment, deferment or default status. Loans that are in an in-school status cannot be included in a Direct Consolidation Loan.

The Company is in the process of evaluating the impact of the program to its consolidated statement of financial position and cash flows.

Management has evaluated subsequent events through January 27, 2012, the date which the consolidated financial statements were available to be issued.