

# Higher Education Loan Authority of the State of Missouri

Financial Statements as of and for the  
Years Ended June 30, 2011 and 2010,  
Supplementary Schedule of Expenditures of Federal  
Awards for the Year Ended June 30, 2011, and  
Independent Auditors' Reports

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the  
Higher Education Loan Authority  
of the State of Missouri  
Chesterfield, Missouri

We have audited the accompanying statements of net assets of the Higher Education Loan Authority of the State of Missouri (the "Authority") as of June 30, 2011 and 2010, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These basic financial statements are the responsibility of the management of the Authority. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the Higher Education Loan Authority of the State of Missouri, as of June 30, 2011 and 2010, and its changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The financial statements include an allowance for loan loss of \$23.4 million and \$10.9 million as of June 30, 2011 and 2010, respectively. As discussed in Note 2 to the financial statements, during the year ended June 30, 2011 management of the Authority revised its method of estimating the allowance for loan loss due to increased delinquencies and other factors.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 20, 2011, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3–14 and the Schedule of Funding Progress on page 48 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Higher Education Loan Authority of the State of Missouri's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Higher Education Loan Authority of the State of Missouri's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. This supplementary information is the responsibility of the Higher Education Loan Authority of the State of Missouri's management. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects in relation to the basic financial statements taken as a whole.

The logo for Deloitte & Touche LLP, featuring the company name in a cursive script.

September 20, 2011

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEARS ENDED JUNE 30, 2011 AND 2010 (Unaudited)

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The Management Discussion and Analysis of the financial performance of the Higher Education Loan Authority of the State of Missouri (the "Authority") is required supplementary information. This discussion and analysis provides an analytical overview of the Authority's condensed financial statements and should be read in conjunction with the financial statements that follow.

### THE AUTHORITY

The Authority is recognized as one of the largest nonprofit student loan secondary markets in America by statistics gathered and maintained by the U.S. Department of Education. The Authority is a leading holder and servicer of student loans with over \$4.2 billion in assets.

The Authority was created by the General Assembly of the State of Missouri through passage of House Bill (HB) 326, signed into law on June 15, 1981, in order to insure that all eligible post-secondary education students have access to guaranteed student loans. The legislation was amended, effective August 28, 1994, effective August 28, 2003, and again effective May 2, 2008 to provide the Authority with generally expanded powers to finance, originate, acquire, and service student loans, including, but not limited to, those guaranteed or insured pursuant to the Higher Education Act.

The passage of HB 221, effective August 28, 2003, allowed the Authority to originate Parent Loans for Undergraduate Students (PLUS loans) and extended the date for repayment of bonds issued by the Authority from 30 to 40 years. The bill also repealed sections of law setting restrictions on variable-rate unsecured loans. The repeal of variable rate restrictions allowed the Authority to restructure the rates assessed for the Supplemental and Qualified Institution Loan Programs.

The passage of Senate Bill (SB) 389, effective August 28, 2007, further amended the Authority's purpose in order to support the efforts of public colleges and universities to create and fund capital projects, and in order to support the Missouri Technology Corporation's ability to work with colleges and universities in identifying opportunities for commercializing technologies, transferring technologies, and to develop, recruit, and retain entities engaged in innovative technologies. In addition, powers of the Authority were amended to include fund transfers to the Lewis and Clark Discovery Fund (discussed in the footnotes to the financial statements) and authorized the Authority to participate in any type of financial aid program that provides grants and scholarships to students.

The enactment of SB 967 on May 2, 2008, allowed the Authority to originate Stafford loans, however "the Authority's origination of Stafford loans under the Federal Family Education Loan Program (FFELP) shall not exceed ten percent of the previous year's total Missouri FFELP volume as determined by the Student Market Measure report, data from the U.S. Department of Education or other reputable sources." The Authority disbursed just under \$1.9 million of Stafford loans during fiscal 2011 compared to \$155 million for fiscal 2010.

Due to the enactment on March 30, 2010, of the Health Care and Education Reconciliation Act of 2010 (HCERA) which included the Student Aid and Fiscal Responsibility Act (SAFRA) and eliminated the FFELP effective July 1, 2010 including the origination of new FFELP loans after June 30, 2010, the Authority has not originated FFELP loans since July 1, 2010. As of July 1, 2010, all loans made under the Higher Education Act are originated under the Federal Direct Student Loan Program (Direct Loan Program). The terms of

existing FFELP loans are not materially affected by the HCERA. However, the Authority is already pursuing a contract with the U. S. Department of Education (the “Department”) to service Direct Loans in accordance with the HCERA, Public Law 111-152, which requires the Secretary to contract with each eligible and qualified not-for-profit (NFP) servicer to service loans. The Department began the process to identify eligible NFP servicers by issuing a sources sought notice, the SAFRA Not For Profit Eligibility Information Request – Solicitation Number: NFP-SS-2010, requesting interested organizations to submit information demonstrating eligibility against the criteria specified in the HCERA (e.g., the organization was a NFP servicer entity and serviced FFELP loans on July 1, 2009). The Department is expected to allocate 100,000 borrower accounts to each qualified NFP servicer.

The Authority suspended its supplemental loan programs during fiscal 2008 due in part to credit market disruptions, which make financing these loans more difficult. The Authority’s loan program was suspended due to increasing delinquencies and defaults in the Authority’s existing portfolio, as well as the creation of the Federal Grad PLUS program, which increased the risk profile of future supplemental loans that are now made predominantly to undergraduate students as opposed to graduate and professional students.

The Authority responded to the request for information and was among the first twelve NFP servicers that the Department determined met the NFP servicer eligibility criteria under the HCERA. The Authority applied to the Department of Education on November 24, 2010, to be permitted to proceed to develop a Memorandum of Understanding. On February 2, 2011, the Department published a determination that the Authority was permitted to enter into a Memorandum of Understanding to pursue an Authorization to Operate (ATO) and a contract award as a NFP servicer. PHEAA (the Pennsylvania Higher Education Assistance Agency) was identified as a key subcontractor for this arrangement. On March 30, 2011, the Authority entered into a Memorandum of Understanding with the Department. If the Authority is subsequently awarded a servicing contract, servicing of loans under the Direct Loan Program by the Authority would begin in late 2011. On June 22, 2011, the Department published an estimated not-for-profit servicer “go-live” date schedule, which listed the Authority’s estimated go-live date as October 2011. The Authority is currently in the final phases of testing with the Department and its contractors and currently expects to receive the first loan transfer from the Department on October 22, 2011. However, no assurance can be given that the Authority actually will be awarded an ATO and a servicing contract to become a NFP servicer to service Direct Loans.

In addition to pursuing a federal loan servicing contract, the Authority also still services nearly \$3.8 billion of its own student loans and \$573 million in lender partner owned loans that will provide the Authority ongoing revenue streams for many years to come. This legacy portfolio and its related revenue will assist the Authority in a gradual and smooth transition to a Direct Loan servicing business model.

The Authority is governed by a seven-member Board, five of whom are appointed by the Governor of the State, subject to the advice and consent of the State Senate, and two others who are designated by statute, the State Commissioner of Higher Education and a member of the State Coordinating Board for Higher Education. Raymond H. Bayer, Jr., appointed by the Board during fiscal 2007, serves as Executive Director and Chief Executive Officer of the Authority.

The Authority owns and services student loans made pursuant to the Higher Education Act under FFELP. Loans previously authorized under FFELP include: (a) loans to students meeting certain financial needs tests with respect to which the federal government makes interest payments available to reduce student interest cost during periods of enrollment (“Subsidized Stafford Loans”); (b) loans to students made without regard to financial need with respect to which the federal government does not make such interest payments (“Unsubsidized Stafford Loans” and, collectively with Subsidized Stafford Loans, “Stafford Loans”); (c) loans to parents of dependent undergraduate and graduate students, or to graduate or professional students (“PLUS Loans”); and (d) loans available to borrowers with certain existing federal educational loans to consolidate repayment of such loans (“Consolidation Loans”). The Authority also owns consolidated Health Education Assistance Loans (HEAL) established by the Public Health Service Act and insured through the

Department of Health and Human Services. In addition, the Authority is the lender and servicer for supplemental loans, which are also known as private or alternative loans. These supplemental loans were previously made available predominantly to students in the Midwest who reached the maximum available funding under FFELP. There are several types of loans under the supplemental program including those for borrowers attending eligible undergraduate, technical, graduate, law, medical, and pharmacy schools. Supplemental loans are not guaranteed by the federal government.

The Authority suspended its supplemental loan programs during fiscal 2008 due in part to credit market disruptions, which make financing these loans more difficult. In addition to increasing delinquencies and defaults in the Authority's existing portfolio, the creation of the Federal Grad PLUS program increased the risk profile of future supplemental loans, which are now made predominantly to undergraduate students as opposed to graduate and professional students.

The Authority purchased/originated \$758.8 million of gross principal student loans from a variety of financial institutions during fiscal 2011. This compares to \$938.5 million of gross principal during fiscal year 2010 and \$842 million of gross principal during fiscal year 2009 representing a 19% decrease for fiscal 2011 compared to an 11.5% increase for fiscal 2010. For fiscal 2011, the Authority purchased \$732.1 million in loans from lender partners and made additional disbursements of \$1.9 million on loans with initial disbursements prior to June 30, 2010. The remaining \$24.8 million consisted of \$14.0 million rehabilitated loans purchased from the Missouri guaranty agency at a discount and \$10.8 million in repurchases from various guarantors of loans that had previously been in a bankruptcy status as required by federal law. The Authority purchased \$0.1 million in supplemental loans during fiscal 2011. The Authority also continued to collect servicing fee income from its lender partners for serviced loans that in the past would have been purchased. In fiscal 2011, the Authority's income was supplemented by over \$2.8 million in servicing fee income, which was down from \$7.1 million in fiscal 2010. In addition, in fiscal 2011 the Authority received approximately \$19.8 million in revenues associated with the sale of loans to the Department through the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) Federal Loan Participation Purchase Program compared to \$19.6 million in fiscal 2010.

The net loan activity of new purchases less existing loan principal decreases through borrower and claim payments, cancellation activity, and loan sales, resulted in a decrease of 11% from \$4.2 billion to \$3.8 billion in the student loan portfolio from fiscal 2010 to fiscal 2011 as compared to a 4% decrease from \$4.4 billion to \$4.2 billion from fiscal 2009 to fiscal 2010. As of the end of this fiscal year the student loan portfolio held by the Authority is made up of approximately 39.1% Consolidation Loans, 47.8% Stafford Loans, 7.5% PLUS Loans, 5.6% Supplemental Loans, and less than 0.1% HEAL Loans. This compares to 34.6% Consolidation Loans, 51.5% Stafford Loans, 8.5% PLUS Loans, 5.4% Supplemental Loans, and less than 0.1% HEAL Loans as of fiscal year-end 2010.

During fiscal 2011, the Authority utilized the LIBOR floating rate note (LFRNs) market to purchase loans from its lender partners. On September 28, 2010, the Authority issued \$495.2 million in LFRNs under the 2010-3 Trust to purchase over \$460 million in loans from its lender partners and to purchase over \$22 million in loans from the Authority's general fund. During fiscal 2010, the Authority completed three bond financings totaling \$1.770 billion utilizing the LIBOR floating rate market to refinance troubled variable rate demand notes, failed auction rate securities and fixed rate bonds. In the first transaction, which closed on November 5, 2009, the Authority issued and privately placed \$186.0 million in LFRNs in the 2009-1 Trust to refinance the non Straight-A Conduit eligible assets from the 2005 Trust, which were primarily consolidation loans. In the second transaction, which closed on January 28, 2010, the Authority issued \$761.4 million in LFRNs under the 2010-1 Trust to purchase and extinguish \$819.2 million of failed auction rate bonds from the Eleventh General Student Loan Bond Resolution ("11<sup>th</sup> General") at a discount. In the third transaction, which closed on May 26, 2010, the Authority issued \$822.5 million in LFRNs under the 2010-2 Trust to redeem \$49.8 million in fixed rate bonds from the 6<sup>th</sup> General at a 0.5% premium, to redeem the \$33.9 million in variable rate demand notes from the 8<sup>th</sup> General at par, and to purchase and extinguish \$704.0 million in

failed auction rate bonds from the 11th General at a discount. The \$822.5 million in bond proceeds were also utilized to purchase loans from the Authority's operating fund.

During fiscal 2011, the Authority continued to utilize the ECASLA programs for eligible collateral, as the Authority placed over \$678.7 million in loans in the ECASLA Federal Loan Participation Purchase Program and put over \$690.1 million in loans through the ECASLA Federal Loan Purchase Commitment Program. This compares to the placement of over \$468 million in loans in the ECASLA Federal Loan Participation Program and over \$705.0 million in the ECASLA Federal Loan Purchase Commitment Program during fiscal 2010. The Authority utilized both the Participation and Purchase programs through their respective expiration dates, which were September 17, 2010 and October 15, 2010. The Authority will continue to utilize the ECASLA Straight-A Conduit during fiscal 2012 as that program is available for existing borrowings through November 19, 2013. As of June 30, 2011, the Authority had \$237.1 million in borrowings outstanding under the Straight-A Conduit compared to \$282.1 million in fiscal 2010. The Authority did not take any additional draws under the Straight-A Conduit in fiscal 2011 because no new draws are permitted under the program rules. The Authority's final conduit draw was taken in fiscal 2010 on October 30, 2009, in which the Authority funded an additional \$118.6 million in loans through the Straight-A Conduit to refinance eligible assets previously held under the 2005 Trust.

The 2005 Trust Bonds referred to above were credit enhanced by a synthetic letter of credit, which consisted of a standby bond purchase agreement (liquidity provider) and a bond insurance policy. The bond insurer's credit rating was downgraded and most of the bonds were put to the liquidity provider. The put bonds are known as bank bonds, which under the bond documents carry an interest rate indexed to prime. Indexing the bonds to prime led to higher interest rates on the bonds, which were in excess of the yield on the assets resulting in net losses in the trust. As noted above, the Authority was able to work with the transaction parties in the trust to refinance the bonds into the Straight-A Conduit on October 30, 2009 and into the 2009-1 Trust on November 5, 2009.

The Authority continues to focus on the development of creative solutions to support the Authority's mission. In the past, the Authority has offered various rate reduction programs to borrowers who establish payments through automatic deduction as well as various loan forgiveness programs. Beginning in fiscal 2009, the Authority modified its borrower benefits to comply with new requirements related to the Federal ECASLA programs. As a result, borrowers who establish payments through automatic deduction can receive a 0.25% interest rate reduction. In fiscal 2010, the Authority utilized a program called the Director's Choice program that provides three one-thousand dollar hardship grants to needy students for each of the 154 Missouri post-secondary institutions. During fiscal 2010, the Authority provided \$0.4 million in Director's Choice grants. In fiscal 2011, the Authority provided \$30.0 million in funds for the State of Missouri's need based scholarship program, Access Missouri. In addition, in fiscal 2012 the Authority's Board has approved the payment of an additional \$30.0 million to Access Missouri and \$1.0 million to a new state scholarship program titled the Advanced Placement Incentive Grants. The Authority has again set aside \$30.0 million in cash in a separate account for the fiscal 2012 Access Missouri funding. The first payment of \$9.0 million was made to the State of Missouri on September 1, 2011, with subsequent payments of varying amounts planned on the first of the month for the next seven months. The Authority reserves the right to modify these programs as needed. In addition, the Authority has granted over \$48.5 million in loan forgiveness for a variety of student borrowers including teachers, Pell Grant recipients, and those in military service. Borrowers received over \$1.2 million in loan forgiveness during fiscal 2011, in addition to \$9.4 million during fiscal 2010 and \$2.1 million during fiscal 2009.

## **FINANCIAL POSITION**

This report includes three financial statements: the statements of net assets; the statements of revenues, expenses, and changes in net assets; and the statements of cash flows. These financial statements are prepared in accordance with Government Accounting Standards Board principles. The statements of net assets present



the financial position of the Authority at the end of the fiscal year and include all assets and liabilities of the Authority. The statements of revenues, expenses, and changes in net assets present the Authority's results of operations. The statements of cash flows provide a view of the sources and uses of the Authority's cash resources.

Condensed financial information and a brief synopsis of the variances follow:

**CONDENSED STATEMENTS OF NET ASSETS**  
(In thousands)

	2011	2010	2009
Cash and cash equivalents	\$ 353,849	\$ 242,721	\$ 145,363
Accrued interest receivable	89,037	112,844	136,868
Capital assets	16,858	14,045	14,182
Other	26,449	25,435	24,991
Student loans receivable	<u>3,776,452</u>	<u>4,229,752</u>	<u>4,415,659</u>
Total assets	<u>\$ 4,262,645</u>	<u>\$ 4,624,797</u>	<u>\$ 4,737,063</u>
Current liabilities	\$ 458,578	\$ 950,145	\$ 783,136
Long-term liabilities	<u>3,498,395</u>	<u>3,359,542</u>	<u>3,785,520</u>
Total liabilities	<u>\$ 3,956,973</u>	<u>\$ 4,309,687</u>	<u>\$ 4,568,656</u>
Invested in capital assets	\$ 16,858	\$ 14,045	\$ 14,182
Restricted	204,415	217,214	126,276
Unrestricted	<u>84,399</u>	<u>83,851</u>	<u>27,949</u>
Total net assets	<u>\$ 305,672</u>	<u>\$ 315,110</u>	<u>\$ 168,407</u>

**CONDENSED STATEMENTS OF REVENUES,  
EXPENSES AND CHANGES IN NET ASSETS**  
(In thousands)

Interest on loans	\$ 186,231	\$ 187,621	\$ 237,404
Special allowances	(86,874)	(89,617)	(47,953)
ECASLA income	19,770	19,578	
Gain on extinguishment of debt	4,785	139,461	
Investment income and other	<u>4,465</u>	<u>7,440</u>	<u>4,665</u>
Total operating revenues	<u>128,377</u>	<u>264,483</u>	<u>194,116</u>
Bond expenses	46,196	58,510	131,021
Student loan expenses	32,841	25,139	26,752
Administrative and general expenses	<u>58,778</u>	<u>34,131</u>	<u>31,358</u>
Total operating expenses	<u>137,815</u>	<u>117,780</u>	<u>189,131</u>
Operating income before special items	(9,438)	146,703	4,985
Special items	<u>-</u>	<u>-</u>	<u>51,354</u>
Change in net assets	<u>\$ (9,438)</u>	<u>\$ 146,703</u>	<u>\$ 56,339</u>

## FINANCIAL ANALYSIS

### Financial Position

Total assets decreased \$362.2 million compared to a decrease in liabilities of \$352.7 million resulting in a decrease to the Authority's net assets of \$9.4 million in fiscal 2011. This decrease compares unfavorably to an increase of \$146.7 million in fiscal 2010. The change in net assets in fiscal 2011 is primarily tied to the Authority's \$30.0 million contribution to the State of Missouri for student scholarships. In fiscal 2010, the change in net assets was primarily the result of net gains on the extinguishment of debt of \$139.5 million, which included two large purchases and extinguishments of \$819.2 million and \$704.0 million in bonds at a discount, the refinancing of the 2005 Trust Indenture and several smaller purchases and extinguishments of bonds at a discount.

Cash and cash equivalents increased by 46% to \$353.8 million in fiscal 2011 from \$242.7 million in fiscal 2010, as compared to a 67% increase from \$145.4 million in fiscal 2009 to fiscal 2010. The current and prior year increases in cash are due to the loss of recycling in all but one trust estate, which prevents cash from being reinvested in student loans. As required by the bond resolutions, this cash must predominantly be utilized for the purchase and extinguishment of debt or the optional redemption of debt.

Accrued interest receivable is down 21% from fiscal 2010 as compared to a 18% decrease from fiscal 2009 to fiscal 2010 and is a direct result of the decrease in student loans receivables in an in-school and in-grace status from fiscal 2010 to 2011.

Other assets, which include deferred charges, pension asset, as well as miscellaneous receivables and prepaid expenses, increased from \$25.4 million in fiscal 2010 to \$26.5 million in fiscal 2011. The change is the result of a \$1.8 million increase in the short and long-term deferred charges from \$17.2 million in fiscal 2010 to over \$19.1 million in fiscal 2011. The increase in short and long-term deferred charges is due to the unamortized costs of issuance associated with the Authority's new bond transaction the 2010-3 Libor floating rate notes. This increase was partially offset by a \$0.6 million reduction in miscellaneous receivables and prepaids as well as a \$0.3 million reduction in the pension asset.

Student loans receivable decreased 11% from \$4.2 billion in fiscal 2010 to \$3.8 billion in fiscal 2011 as compared to a 4% decrease from \$4.4 billion in fiscal 2009 to \$4.2 billion in fiscal 2010. The fiscal 2011 decline is primary related to the Authority's sale of over \$690.3 million in the ECASLA purchase program and the net of purchase activity less loan principal reductions during fiscal 2011 and fiscal 2010. Similar to the current year, the fiscal 2010 decline is primarily related to the Authority's sale of over \$705.0 million in loans through the ECASLA purchase program and the net of the purchase activity less loan principal reductions during fiscal 2010 and fiscal 2009.

For fiscal 2011, current liabilities decreased by \$491.6 million due to decreases in ECASLA participation payable of \$468.8 million, Conduit payable of \$45.0 million, other liabilities of \$5.2 million and accrued interest payable of \$1.4 million, which was partially offset by a \$27.0 million increase in current bonds payable. Long-term liabilities increased by \$138.9 million or 4% as the Authority issued an additional \$495.2 million in LFRNs in September 2010. This increase was partially offset by \$71.3 million in bond redemptions and cancellations during the year. The overall decrease in total liabilities is the result of the aforementioned reduction in the ECASLA and Conduit payables as well as the bond redemptions. In fiscal 2010, total liabilities decreased \$259.0 million from fiscal 2009 levels due to bond extinguishments and redemptions. Despite the overall decrease in liabilities in fiscal 2010, the Authority did complete three new bond issuances of \$186.0 million, \$761.4 million and \$822.5 million and utilized the federal ECASLA participation program and Straight-A Conduit to finance student loans. However, the \$1.8 billion in bond issuances were offset by \$2.2 billion in bond extinguishments and redemptions in fiscal 2010. During fiscal

2010, the Authority also closed its \$80.0 million revolving line of credit with three banks that served as a “bridge” financing for the Authority’s utilization of the ECASLA Federal Loan Participation Program.

## **Operating Results**

Change in net assets decreased 106% to (\$9.4) million in fiscal 2011 from \$146.7 million in fiscal 2010 due primarily to the significant reduction in the activity associated with the net gain on the extinguishment of debt, which decreased from \$139.5 million in fiscal 2010 to \$4.8 million in fiscal 2011, the \$30.0 million scholarship contribution to the State of Missouri and the \$10.6 million increase in provision for loan losses. This is a year over year decrease of (\$156.1) million from fiscal 2010, as compared to an increase of \$90.4 million from fiscal 2009 to fiscal 2010. The Authority utilized cash contained in the various trusts to complete several small bond purchases at a discount, which resulted in the \$4.8 million in gains on the extinguishment of debt. During fiscal 2010, the net gain on extinguishment of debt totaling \$139.5 million primarily came from three bond financings. Two of the transactions involved the purchase and subsequent extinguishment of \$819.2 and \$704.0 million of failed auction rate bonds from the 11th General Resolution at a discount. These two transactions resulted in gross gains of \$45.8 million and \$67.8 million respectively for a total gain of \$113.6 million. When adjusted for the write-off of unamortized costs of issuance associated with the extinguished debt of \$2.7 million and \$3.0 million respectively, as well as a premium expense of \$0.2 million, the net gain related to these two transactions was \$107.7 million. Bond proceeds from the issuance of LFRNs under the 2010-1 and 2010-2 facilitated the 11th General bond purchases. The third transaction was related to the redemption of the 2005 Trust Indenture bonds, which resulted in a gross gain of \$24.0 million that when adjusted for the write-off of \$1.0 million in related unamortized costs of issuance, resulted in a net gain of \$23.0 million. Proceeds from the issuance of the LFRNs under the 2009-1 Trust and a Straight-A Conduit draw assisted in the redemption of the 2005 Trust. In addition to these three large transactions, the Authority also utilized cash contained in the various trusts to complete several smaller purchases at a discount, which contributed \$11.0 million in gross gains on the extinguishment of debt that when adjusted for the write-off of \$2.1 million in associated unamortized costs of issuance, provided a net gain of \$8.9 million.

When adjusted for the net gain on extinguishment of debt, other income and the ECASLA put and lender fee subsidy which totaled \$25.7 million, the Authority’s core operating income declined \$2.8 million or 3%. The primary factor impacting the change in net assets before net gain on the extinguishment of debt, other income and the ECASLA related subsidy was the \$4.3 million reduction in servicing fee revenue. Servicing fee revenue declined as the Authority purchased loans from lender partners whom were being charged by the Authority to service those loans. This reduction was partially offset by the \$1.4 million net increase in the yield on student loans. As indicated in detail below, the \$1.4 million increase in the lender yield on the Authority’s assets is represented by the \$3.8 million increase in interest on student loans, the \$2.7 million improvement in the special allowance subsidy, and the \$5.2 million reduction in interest subsidies. This increase in core operating income is complemented by the \$10.1 million reduction in interest expense on the bonds that finance those assets. Additionally, fiscal 2011 saw a slight increase of \$0.2 million in investment income due to higher cash balances during the period. Operating income in fiscal 2011 also benefited from \$1.1 million in other income.

Total operating revenue decreased 51% from fiscal 2010 to fiscal 2011 as compared to a 36% increase from fiscal 2009 to fiscal 2010. As noted above, the primary reason for the decrease was related to the \$134.7 million reduction in net gains on the extinguishment of debt. The decrease in special allowance is a result of the increase in the level of higher yielding loans in repayment from \$3.5 billion in fiscal 2010 to \$3.6 billion in fiscal 2011 and the decrease in the mix of lower yielding loans in a in-school and in- grace status from 17% (\$734.4 million) of the portfolio in fiscal 2010 to 5% (\$205.5 million) of the portfolio in fiscal 2011. In-school and in-grace status Stafford loans have a 60 basis point lower yield to the Authority than in-repayment Stafford loans. This decrease was in part offset by a drop in the 90-day AA financial

commercial paper rate (CP rate) from an average of 0.28% in fiscal 2010 to an average of 0.25% in fiscal 2011. For example, federal law requires the Authority to charge a parent an 8.5% interest rate on a PLUS loan originated after July 1, 2006, which the Authority collects from the parent borrower. However, the Authority only earns a yield on that loan at the CP rate plus 1.94%. The CP rate for quarter ended June 30, 2011 was just 0.19%, which means the Authority's annual yield for that quarter was only 2.13%. The Authority is required to rebate the additional interest paid by the borrower of 6.37% (8.5% - 2.13%) to the Department through the rebate of excess special allowance. Examples of the rates driving student loans and an explanation regarding 9.5% floor income follow in the next several paragraphs.

Fixed rate unsubsidized Stafford loans made on or after July 1, 2006 and subsidized Stafford loans made between July 1, 2006 and June 30, 2008 in all loan statuses bear interest at 6.8%. Fixed rate subsidized Stafford loans made between July 1, 2008 and June 30, 2009 bear interest at 6.0%, while the same loans made between July 1, 2009 and June 30, 2010 bear interest at 5.6%. Subsidized and unsubsidized Stafford loans made on or after July 1, 1998 and before July 1, 2006 that are in a status other than in-school, grace or deferment bear interest at a rate equivalent to the 91-day T-Bill rate plus 2.30%, with a maximum rate of 8.25%. Loans made within the same period with in school, grace, and deferment status bear interest at a rate equivalent to the 91-day T-Bill rate plus 1.70%, with a maximum rate of 8.25%. The variable rate loans are adjusted annually on July 1 based on the 91-day T-Bill rate on the last auction date in May. During fiscal 2011, the rate on these loans was set at 2.47% and 1.87% respectively. The rate on the same loans during fiscal 2010 was 2.48% and 1.88% respectively and during fiscal 2009 was 4.21% and 3.61% respectively.

PLUS loans first disbursed on or after July 1, 2006 bear a fixed rate at 8.5%. Variable rate PLUS Loans made on or after July 1, 1998 bear interest at a rate equivalent to the 91-day T-Bill rate plus 3.10%, with a maximum rate of 9%. The rates are adjusted annually on July 1 based on the 91-day T-Bill rate on the last auction date in May. The T-Bill rate used for fiscal 2011 was 0.17%, which set the rate at 3.27% as compared to 3.28% for fiscal 2010 and 5.01% for fiscal 2009. Consolidation Loans for which the application was received by an eligible lender on or after October 1, 1998, bear interest at a rate equal to the weighted average of the loans consolidated, rounded to the nearest higher one-eighth of 1%, with a maximum rate of 8.25%.

The special allowance subsidy is paid on the spread between student loan borrower interest rates, which are either fixed for the life of the loan or fixed for a year, and the commercial paper and 91-day T-Bill rates, which decreased significantly throughout fiscal 2008, fiscal 2009 and fiscal 2010, and slightly in fiscal 2011. This decrease was in large part due to the falling 90-day AA financial commercial paper rates and the increase in the percentage of loans subject to the rebate of excess special allowance payments. In addition, qualified loans within tax-exempt bonds issued prior to October 1993 are eligible to receive a subsidy based upon the greater of the same spread or 9.5%. However, in a Dear Colleague Letter issued on January 23, 2007, the Department clarified the requirements of the statute and regulations that control the qualifications for loans eligible for the 9.5% floor. The Department provided further guidance on this clarification in a Dear Colleague Letter dated April 27, 2007. These requirements include a special audit to determine the eligibility for 9.5% special allowance billings. The Department paid special allowance at the standard rate on any loans that were included in the 9.5% minimum from quarter ending December 31, 2006 until the Department received the results of the special audit of the bonds and the loans within those bonds. This audit was completed and the Authority received a payment of \$0.8 million from the Department for the quarters ended December 31, 2006 through December 31, 2007. The principal balance of loans receiving 9.5% special allowance dropped from \$5.1 million in fiscal 2010 to \$0.5 million by December 31, 2010 quarter end. As a result, the Authority voluntarily stopped billing 9.5% special allowance from quarter beginning April 1, 2011 forward.

Total operating expense realized a 17% increase, or \$20.0 million from fiscal 2010 to fiscal 2011 compared to a 38% decrease, or \$71.4 million from fiscal 2009 to fiscal 2010. The primary reason for the increase in operating expenses is the \$30.0 million scholarship contribution to the State of Missouri. Adjusting for the

\$30.0 million scholarship contribution, the Authority's operating expenses declined 8% or \$10.0 million. Bond interest expense declined from \$51.9 million in fiscal 2010 to \$41.8 million in fiscal 2011, which represents a decrease of 19%. The decline in bond interest expense is the result of a decline in the weighted average interest rates on the Authority's debt, as well as a \$344.9 million reduction in interest bearing debt. Bond interest rates generally fell as broader market interest rates declined. The Authority continued to experience various interest rate spikes on its debt in fiscal 2011 due to the failure of the auction rate market, which set those bonds at the maximum rate under the bond documents. However, the amount of outstanding auction rate securities continued to decline from \$746.0 million in fiscal 2010 to \$675.7 million in fiscal 2011. The reduction in bond interest expense was accompanied by reductions of \$1.5 million in bond maintenance fees and \$0.7 million in letter of credit fees. As a result, total bond related expenses declined over 21% to \$46.2 million in fiscal 2011 from \$58.5 million in fiscal 2010.

Total student loan related expenses increased from \$25.1 million in fiscal 2010 to \$32.8 million in fiscal 2011, which represents a 31% increase. The increase is due to a \$10.6 million increase in the provision for loan losses from \$8.0 million in fiscal 2010 to \$18.6 million in fiscal 2011. The significant increase in provision for loan losses is due to a change in management's methodology related to the future loan loss estimates for the supplemental portfolio. Management's new methodology for the supplemental portfolio incorporates loan seasoning and loan type (graduate or undergraduate) into the methodology. The Authority also altered its FFELP loan loss methodology to better incorporate the increase in defaults associated with current economic conditions. During fiscal 2011, the Authority continued to experience increases in delinquencies in its supplemental loan portfolio as the percentage of supplemental loans over 120 days past due increased to 10.12% from 6.72% in fiscal 2010. During fiscal 2011 the Authority, charged-off an additional \$4.7 million in supplemental loans, net of recoveries that were over 270 days past due. In the FFELP portfolio, the Authority wrote-off \$1.4 million and provisioned \$1.1 million for probable losses. Partially offsetting the increases associated with the provision for loan losses were reductions of \$1.5 million in origination fees, \$0.1 million in default fees and a very slight reduction in consolidation rebate fees. Origination and default fees declined to near \$0.1 million due to the elimination of the FFEL program for new loans after June 30, 2010.

Arbitrage rebate liability is calculated based upon the earnings of tax-exempt debt. The arbitrage liability was affected by decreased bond earnings and the further reduction of those earnings through student borrower benefit programs. During fiscal 2011, the Authority processed loan forgiveness of approximately \$1.2 million. The arbitrage rebate liability declined \$3.0 million in fiscal year 2011 to \$1.7 million compared to a decrease of \$9.5 million in fiscal 2010. The reduction of arbitrage rebate liability produced \$1.9 million in income for fiscal 2011 compared to \$0.7 million in fiscal 2010.

Administrative and general expenses, which include salaries and fringe benefits, postage and forms, third party servicing fees, computer services, professional fees, occupancy expense, depreciation, other operating expenses and scholarship fund; increased 72% compared to a 9% increase in fiscal 2010. However, the majority of this increase is due to the payment of \$30.0 million to the State of Missouri for student scholarships. Adjusting for the scholarship fund contribution, the Authority's general and administrative expenses declined \$5.4 million or 16%. This decline was due to reductions in salaries and employee benefits, postage and forms, third party servicing fees, computer services and other operating expenses. Salaries and employee benefit related expenses decreased by \$1.7 million or 10% from fiscal 2010 to fiscal 2011. Third party servicing fees declined \$2.7 million due to the conversion of loans to in-house servicing in late fiscal 2010, and computer services declined \$1.4 million. Postage and forms declined by \$0.3 million and other operating expenses declined by \$0.2 million. These reductions were offset slightly by increases of \$0.8 million in professional fees associated with the direct loan servicing effort as well as the \$0.2 million combined increase in depreciation and occupancy expense.

As noted above, the primary reason for the \$9.4 million decrease in net assets was related to the \$30.0 million student scholarship contribution to the State of Missouri. Restricted net assets decreased by \$12.8 million from \$217.2 million in fiscal 2010 to \$204.5 million in fiscal 2011, while unrestricted net assets increased by \$0.5 million from \$83.9 million in fiscal 2010 to \$84.4 million in fiscal 2011. During fiscal 2010, the primary reason for the \$146.7 million increase in net assets was related to activity associated with the \$139.5 million net gain on extinguishment of debt. Restricted net assets increased by \$90.1 million from \$126.3 million in fiscal 2009 to \$217.2 million in fiscal 2010, while unrestricted net assets increased by \$56.8 million from \$27.9 million in fiscal 2009 to \$83.9 million in fiscal 2010.

## **Continuing Developments**

### *The Ensuring Continued Access to Student Loans Act of 2008*

On May 7, 2008, the President signed House Resolution 5715, the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). A key provision of ECASLA grants temporary authority to the Secretary of Education to purchase or enter into forward commitments to purchase student loans first disbursed under sections 428, 428B or 428H of the Higher Education Act on or after October 1, 2003 and before July 1, 2009 on such terms as the Secretary determines are in the best interest of the United States. On October 7, 2008, the Participation and Purchase Programs were extended to September 30, 2010 for loans made in the 2009-2010 academic year.

In implementing ECASLA, the Department created two programs, the Federal Family Education Loan Participation Purchase program and the Federal Family Education Loan Purchase Commitment program. The Authority filed its intent to participate in both programs on July 3, 2008 and July 23, 2009 for each program year respectively. The Authority also successfully encouraged many of its lender partners to file their intent to participate in both program years. The Authority began actively utilizing the ECASLA Loan Participation Purchase program in November 2008 for eligible Authority originated loans and the Authority also utilized the program to purchase ECASLA eligible loans from its lender partners. In June 2009, the Authority completed its first put (sale of loans) of \$2.7 million in loans to the Department under the ECASLA Master Loan Sale Agreement. The Authority put over \$1.4 billion in loans to the Department through October 15, 2010. The utilization of this program was the reason for the classification of \$470.6 million in Student Loans Receivable-Available for Sale on the Authority's Statement of Net Assets in fiscal 2010.

The Master Participation Agreement was designed to provide short-term liquidity to eligible lenders for the purpose of financing the origination of FFELP loans. Loans participated in the program were charged a rate of commercial paper plus 50 basis point on the principal amount. All loans under the Participation Program had to either be refinanced by the lender or sold to the Department under the Purchase Program. The Master Loan Sale Agreement allowed eligible lenders to sell FFELP loans originated for the 2008-2009 academic year to the Department through the Purchase Program at 101% plus \$75 per loan. The agreement expired on September 30, 2010.

In May 2009, the Department in conjunction with industry partners established the Asset-Backed Commercial Paper (ABCP) Conduit Program that will help ensure the continued availability of FFELP loans to students and parents for the 2009-2010 academic year. Loans eligible for the Conduit Program included Stafford and PLUS loans with first disbursement dates on or after October 1, 2003 and no later than June 30, 2009, which were fully disbursed before September 30, 2009. The Department entered into a put agreement with the Straight-A Funding LLC Conduit using the authority provided by, and consistent with the requirements of ECASLA.

The Conduit purchases notes secured by eligible FFELP loans from eligible FFELP lenders and holders, which in turn serves as the underlying asset against which the Conduit sells commercial paper. The Conduit

Program provides an advance of 97% of the student loan value. The commercial paper has variable maturities, but in no case longer than 90 days. As previously-issued commercial paper matures, proceeds from newly-issued commercial paper is used to satisfy investors holding earlier maturities. If necessary, the Federal Financing Bank will provide a short-term liquidity backstop to re-finance maturing commercial paper. The Department will purchase loans from the Conduit in order to allow the Conduit to repay such short-term liquidity loans to the extent required. The Conduit Program has a term of five years and expires on November 19, 2013. On June 30, 2011, the Authority had \$237.1 million in borrowings outstanding under the Asset-Backed Commercial Paper Conduit Program.

### *Lewis and Clark Discovery Initiative*

On August 28, 2007, legislation establishing the Lewis and Clark Discovery Initiative (the “Initiative”) became law. The legislation, known as Senate Bill 389 (the “LCDI Legislation”) directs the Authority to distribute \$350.0 million into a new fund in the State Treasury known as the Lewis and Clark Discovery Fund (“Fund”) on the following schedule: \$230.0 million no later than September 15, 2007; an additional \$5.0 million by December 31, 2007; and further installments of \$5.0 million each calendar quarter ending September 30, 2013. Investment earnings on the Fund are credited against subsequent payments by the Authority. In addition, the law provides that the Authority may delay payments if the Authority determines that any such distribution may materially adversely affect the service and benefits provided to Missouri students or residents in the ordinary course of the Authority’s business, the borrower benefit programs of the Authority or the economic viability of the Authority. However, the entire \$350.0 million is to be paid by September 30, 2013 unless otherwise approved by the Authority and the Missouri Commissioner of the Office of Administration. The General Assembly has appropriated amounts to be deposited in the Fund for certain capital projects at public colleges and universities.

The new law provides that following the initial September 15, 2007 distribution by the Authority, the Missouri Director of Economic Development shall allocate to and reserve for the Authority in 2007 and the next 14 years at least 30% of Missouri’s tax-exempt, private activity bond cap allocation. This allocation was \$150.0 million for 2007. The amount of this allocation may be reduced for 2014 and later years by the percentage of the \$350.0 million not paid by the Authority to the Fund by the end of the preceding year.

On September 7, 2007 the Members of the Authority’s Board approved a resolution to fund the initial payment of \$230.0 million to the Lewis and Clark Discovery Fund in the Missouri State Treasury no later than September 14, 2007 pursuant to the terms of the new law relative to the LCDI Legislation. On September 14, 2007, in accordance with the Board’s Resolution and Missouri Senate Bill 389, the Authority sent a \$230.0 million wire to the Missouri State Treasury. On November 6, 2007, the Members of the Authority’s Board approved a resolution to fund the first quarterly payment of \$5 million less interest income earned on the funds on deposit with the State Treasurer. The net payment paid on December 31, 2007 was \$2.9 million. On March 28, 2008, the Members voted to make a partial payment for March 31, 2008, equivalent to the interest income already earned and on deposit in the fund at the State Treasurer’s Office. On June 26, 2008, the Board approved a resolution to make a payment of \$0.927 million, which after including interest income earned from December 1, 2007 through June 30, 2008 of \$4.1 million, results in the Authority making the full \$5.0 million payment that was due on March 31, 2008. The Board also voted on June 26, 2008 to delay making the June 30, 2008 quarterly payment. On September 12, 2008, the Board voted to make a partial quarterly payment on September 30, 2008 of \$0.1 million. For each subsequent quarterly payment through year ended June 30, 2011, the Board did not authorize payment. On July 21, 2010, the Authority received a two-year extension from the Commissioner of the Office of Administration on the payment of LCDI funds to September 30, 2015. The two-year extension was approved as a part of the Authority’s agreement to provide \$30.0 million in Missouri College Access funds for need based scholarships to the State during the 2011 fiscal year. On July 7, 2011, the Authority received a three-year extension from the Commissioner of the Office of Administration on the payment of LCDI funds to September 30, 2018. The

three-year extension was approved as a part of the Authority's agreement to provide \$30.0 million in Missouri College Access funds for need based scholarships to the State during the 2012 fiscal year. This amount will partially offset dramatic reductions in scholarship funding by the State of Missouri due to budget shortfalls.



# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## STATEMENTS OF NET ASSETS AS OF JUNE 30, 2011 AND 2010 (Dollars in thousands)

ASSETS	2011	2010	LIABILITIES AND NET ASSETS	2011	2010
<b>CURRENT ASSETS:</b>			<b>CURRENT LIABILITIES:</b>		
Cash and cash equivalents:			Conduit payable	\$ 237,093	\$ 282,049
Restricted	\$ 108,038	\$ 107,738	Other liabilities	8,177	13,401
Unrestricted	<u>245,811</u>	<u>134,983</u>	Bonds payable	171,160	144,155
Total cash and cash equivalents	<u>353,849</u>	<u>242,721</u>	ECASLA payable		468,817
Student loans receivable	338,704	315,835	Accrued interest payable	3,259	4,618
Student loans receivable — available for sale		470,596	Special allowance subsidy payable	<u>38,889</u>	<u>37,105</u>
Accrued interest receivable:			Total current liabilities	<u>458,578</u>	<u>950,145</u>
Interest subsidy — U.S. Secretary of Education:	10,915	13,164	<b>LONG-TERM LIABILITIES:</b>		
Student loans receivable (less allowance for doubtful amounts, \$854 in 2011 and \$533 in 2010)	78,122	90,619	Bonds payable	3,496,701	3,354,817
Student loans receivable — available for sale		9,061	Arbitrage rebate payable	<u>1,694</u>	<u>4,725</u>
Miscellaneous receivables and prepaid expenses	2,342	2,912	Total long-term liabilities	<u>3,498,395</u>	<u>3,359,542</u>
Deferred charges	<u>1,178</u>	<u>1,200</u>	Total liabilities	<u>3,956,973</u>	<u>4,309,687</u>
Total current assets	<u>785,110</u>	<u>1,146,108</u>	<b>NET ASSETS:</b>		
<b>LONG-TERM ASSETS:</b>			Invested in capital assets	16,858	14,045
Student loans receivable (less allowance for doubtful loans, \$23,368 in 2011 and \$10,901 in 2010)	3,437,748	3,443,321	Restricted	204,415	217,214
Pension asset	5,056	5,306	Unrestricted	<u>84,399</u>	<u>83,851</u>
Deferred charges, at cost less accumulated amortization of \$2,768 in 2011 and \$11,341 in 2010	17,873	16,017	Total net assets	305,672	315,110
Capital assets, at cost less accumulated depreciation of \$6,269 in 2011 and \$7,187 in 2010	<u>16,858</u>	<u>14,045</u>			
Total long-term assets	<u>3,477,535</u>	<u>3,478,689</u>			
<b>TOTAL</b>	<u>\$4,262,645</u>	<u>\$4,624,797</u>	<b>TOTAL</b>	<u>\$4,262,645</u>	<u>\$4,624,797</u>

See notes to financial statements.

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

(Dollars in thousands)

	2011	2010
OPERATING REVENUES:		
Interest on student loans	\$ 160,158	\$ 156,349
U.S. Secretary of Education:		
Interest subsidy	26,073	31,272
Special allowance	(86,874)	(89,617)
Investment income — interest on cash and cash equivalents	491	310
Servicing fee	2,824	7,130
Gain on extinguishment of debt	4,785	139,461
ECASLA income	19,770	19,578
Other	<u>1,150</u>	<u>          </u>
Total operating revenues	<u>128,377</u>	<u>264,483</u>
OPERATING EXPENSES:		
Interest expense	41,809	51,922
Bond maintenance fees	2,047	3,513
Letter of credit fees	<u>2,340</u>	<u>3,075</u>
Total bond related expenses	<u>46,196</u>	<u>58,510</u>
Consolidation fees	16,034	16,048
Origination fees	135	1,654
Default fee payments		106
Reduction of arbitrage rebate liability	(1,947)	(670)
Provision for loan losses	<u>18,619</u>	<u>8,001</u>
Total student loan related expenses	<u>32,841</u>	<u>25,139</u>
Salaries and employee benefits	15,192	16,935
Postage and forms	2,181	2,488
Third party servicing fees	317	3,031
Computer services	2,760	4,144
Professional fees	2,671	1,889
Occupancy expense	1,545	1,492
Depreciation	1,254	1,080
Other operating expenses	2,858	3,072
State of Missouri's Scholarship fund	<u>30,000</u>	<u>          </u>
Total general and administrative expenses	<u>58,778</u>	<u>34,131</u>
Total operating expenses	<u>137,815</u>	<u>117,780</u>
CHANGE IN NET ASSETS	(9,438)	146,703
NET ASSETS — Beginning of year	<u>315,110</u>	<u>168,407</u>
NET ASSETS — End of year	<u>\$ 305,672</u>	<u>\$ 315,110</u>

See notes to financial statements.

**HIGHER EDUCATION LOAN AUTHORITY  
OF THE STATE OF MISSOURI**

**STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010  
(Dollars in thousands)**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Student loan and interest purchases and originations	\$ (779,673)	\$ (1,038,684)
Cash received for sale of loans and interest	726,280	670,147
Student loan repayments	675,532	604,537
Payment to employees and vendors	(34,346)	(60,263)
Net settlement of government interest	(57,001)	(61,373)
Payment to State of Missouri's Scholarship Fund	<u>(30,000)</u>	<u>                    </u>
Net cash provided by operating activities	<u>500,792</u>	<u>114,364</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Proceeds from issuance of bonds	495,200	1,769,900
Proceeds from conduit		308,719
Proceeds from ECASLA	221,438	872,345
Repayment of bonds	(321,234)	(2,025,849)
Interest paid on debt	(42,536)	(57,065)
Repayment on conduit	(44,956)	(206,670)
Repayment on ECASLA	(690,255)	(689,128)
Cash paid for bond issuance costs	(3,286)	(12,319)
Cash received for the extinguishment or cancellation of debt	<u>                    </u>	<u>24,000</u>
Net cash used in noncapital financing activities	<u>(385,629)</u>	<u>(16,067)</u>
<b>CASH FLOWS FROM CAPITAL ACTIVITIES:</b>		
Purchase of capital assets	(4,093)	(939)
Proceeds from sales of capital assets	<u>58</u>	<u>                    </u>
Net cash used in capital activities	<u>(4,035)</u>	<u>(939)</u>
CHANGE IN CASH AND CASH EQUIVALENTS	111,128	97,358
CASH AND CASH EQUIVALENTS — Beginning of year	<u>242,721</u>	<u>145,363</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 353,849</u>	<u>\$ 242,721</u>

(Continued)

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2011 AND 2010 (Dollars in thousands)

	2011	2010
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating income	<u>\$ (9,438)</u>	<u>\$ 146,703</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization:		
Capital assets	1,254	1,080
Prepaid pension	250	263
Loan and letter of credit fees	18,843	33,039
Provision for loan losses	18,619	8,001
Interest expense	41,833	60,740
Recoveries on supplemental loans	(913)	(168)
Reduction in arbitrage rebate liability	(1,947)	(670)
Cash received for the cancellation of debt		(24,000)
Gain on extinguishment of debt	(4,785)	(133,097)
Change in assets and liabilities:		
Decrease in student loans receivable	418,691	148,123
Decrease in accrued interest receivable	23,807	23,975
Increase in miscellaneous receivables and prepaid expenses	(1,266)	(2,867)
Increase in other liabilities, special allowance subsidy payable, and interest payable	(3,440)	(146,758)
Payments for arbitrage rebate liability	<u>(716)</u>	<u>          </u>
Total adjustments	<u>510,230</u>	<u>(32,339)</u>
Net cash provided by operating activities	<u>\$ 500,792</u>	<u>\$ 114,364</u>
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:		
Student loan principal and interest forgiveness	\$ 368	\$ 8,800

See notes to financial statements.

(Concluded)

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2011 AND 2010 (Dollars in thousands)

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### 1. DESCRIPTION OF THE ORGANIZATION

Legislation, which was signed into law on June 15, 1981, by the Governor of the State of Missouri and became effective on September 28, 1981, created the Higher Education Loan Authority of the State of Missouri (the "Authority") for the purpose of providing a secondary market for loans made under the Federal Family Education Loan Program provided for by the Higher Education Act (FFELP). The legislation was amended, effective August 28, 1994, effective August 28, 2003, and again effective May 2, 2008, to provide the Authority with generally expanded powers to finance, originate, acquire, and service student loans, including, but not limited to, those guaranteed or insured pursuant to the Higher Education Act. The Authority is assigned to the Missouri Department of Higher Education. However, by statute, the State of Missouri is in no way financially accountable for the Authority. Student loan revenue bonds outstanding are payable as specified in the resolutions authorizing the sale of bonds. The bonds are not payable from funds received from taxation and are not debts of the State of Missouri or any of its other political subdivisions.

The Authority has also historically been one of the lenders for supplemental loans made available to students in the Midwestern region who have reached the maximum available under the FFELP. The balance of these loans outstanding is approximately 5% of the total loan receivable balance. During fiscal year 2008, the Authority discontinued originating supplemental and consolidated loans.

On March 30, 2010, the President signed into law The Health Care and Education Reconciliation Act of 2010, which included the Student Aid and Fiscal Responsibility Act (SAFRA). Effective July 1, 2010, the legislation eliminates the authority to provide new loans under FFELP and requires that all new federal loans are to be made through the Direct Loan Program (DLP). The new law does not alter or affect the terms and conditions of existing FFELP loans. The Authority will continue to service and purchase FFELP loans. The Authority expects to be able to remain a going-concern while servicing the existing FFELP loans currently on the statements of net assets. The Authority is currently in the process of restructuring its operations to reflect this change in law. The Authority has appointed a five member team from its senior management to lead the Direct Loan Servicing effort, and is diligently pursuing a Direct Loan servicing contract with the U.S. Department of Education.

On June 11, 2010, the Authority's Board approved the creation of the Missouri Scholarship Foundation (the "Foundation"), the appointment of the initial board of directors and provided initial funding of \$100. The Foundation was incorporated as a Missouri nonprofit corporation for the primary purposes of receiving gifts and grants, to raise funds, accepting transfers and contributions, and using the resulting funds for (1) administering grant, scholarship and related programs on behalf of the Authority and other entities and (2) assisting students who are residents of the State of Missouri and students who attend post-secondary institutions located or based in the State of Missouri to gain access to and finance their post-secondary education. The Foundation has been approved by the IRS as a tax-exempt 501(c)(3) entity for federal tax purposes.

The Bylaws of the Foundation call for the Foundation to be governed by a Board of 3-13 Directors (initially there are 3). Directors are appointed by the existing Board of Directors of the Foundation after

the proposed appointments are submitted to the Authority for approval. Any Director elected by the Board of Directors can be removed without cause by the Authority. The current Foundation Directors include the Authority's Executive Director and General Counsel as well as the Assistant Commissioner of Higher Education from the Missouri Department of Higher Education. The Executive Director of the Authority serves as a voting member of the Board ex officio. The Authority must approve any amendments to the Bylaws or Articles of Incorporation of the Foundation. The Foundation may only appoint an executive director, responsible for overseeing the Foundation's day-to-day operations, with the approval of the Authority.

The Foundation can be dissolved by its own Board of Directors with approval from the Authority. Upon dissolution, any remaining net assets would be reverted to the Authority. The Authority does not have the unilateral authority to dissolve the Foundation; dissolution requires first the action of its own Board of Directors.

While the Foundation meets the definition of a component unit that should be discretely presented alongside the Authority's financial statements, the activities and balances of the Foundation are immaterial in relation to those of the Authority and their omission would not be significant or misleading to financial statement readers, nor would their omission be considered a material departure from generally accepted accounting principles. As a result, the Authority has chosen to exclude the Foundation based upon its current lack of materiality in relation to the financial statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation and Accounting** — The Authority's financial statements have been prepared on the basis of the governmental enterprise fund concept which pertains to financial activities that operate similarly to a private business enterprise. The Authority's funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. In accordance with Governmental Accounting Standards Board (GASB) Codification Section P80, *Proprietary Fund Accounting and Financial Reporting*, the Authority has elected to apply all Financial Accounting Standards Board (FASB) statements and interpretations issued after November 1989 except those that conflict or contradict with the GASB codification.

In accordance with the bond and other borrowing resolutions, the Authority utilizes fund accounting principles, whereby each fund is a separate set of self-balancing accounts. The assets of each bond fund are restricted pursuant to the bond resolutions. To accomplish the various public purpose loan programs empowered by its authorizing legislation and to conform with the bond and note resolutions and indentures, the Authority records financial activities in the various operating and bond related funds (see Note 14). Administrative transactions and those loan transactions not associated with the Authority's bond issues are recorded in the Operating Fund. For financial statement presentation purposes, the funds have been aggregated into one proprietary fund type.

**Use of Estimates** — The preparation of the Authority's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the statement of net assets dates and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the arbitrage rebate payable, allowance for doubtful loans, and calculation of current and long-term student loans receivable and current and long-term bonds payable.

**Cash Equivalents** — The Authority considers all investment securities with original maturities of less than 90 days at the date of purchase to be cash equivalents. All cash equivalents whose proceeds are restricted for debt service reserve and the payment of rebate liabilities are classified as restricted cash equivalents (see Note 7).

**Student Loans Receivable** — Student loans receivables are stated at the principal amount outstanding adjusted for premiums. The related interest income generated from the loans is offset by premium amortization expense. Premiums on student loans are amortized over the estimated life of new loans purchased using a method that approximates the effective interest method. Because the Authority holds a large number of similar loans, the life of the loans can be estimated while considering expected amounts of prepayments from borrowers and loan consolidations. During the years ended June 30, 2011 and 2010, the estimated life of new loans purchased was three years. In addition, for the years ended June 30, 2011 and 2010, the Authority expensed all premiums for pools of loan purchases with less than \$40 of initial premiums. The Authority also purchases rehabilitated and other student loans at a discount. The discount income associated with these purchases are accreted over three years.

Interest on student loans is accrued based upon the actual principal amount outstanding. The U.S. Secretary of Education makes quarterly interest payments on subsidized loans until the student is required, under the provisions of the Higher Education Act, to begin repayment. Repayment must begin generally within six months after the student completes his or her course of study, leaves school, or ceases to carry at least one-half the normal full-time academic load as determined by the participating institution.

The U.S. Secretary of Education provides a special allowance to student loan owners participating in the FFELP. The special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of the three-month financial Commercial Paper (CP) rate, to the average daily unpaid principal balance and capitalized interest of student loans held by the Authority. The special allowance is accrued as earned or payable. For loans first disbursed prior to January 1, 2000, the 91-day Treasury bill rate is used rather than the three-month financial CP rate.

The Authority as a loan owner, does not necessarily earn what a borrower pays. Special allowance was designed to ensure loan owners earned a market rate of interest by making up the difference between what a borrower pays in interest (borrower rate) under federal law and what a loan owner earns (lender yield) on the loan under federal law. Borrower interest rates for Stafford and PLUS loans first disbursed between July 1, 1998 and June 30, 2006 were variable rates set annually based on the 91-day Treasury bill plus a spread of 1.70% to 3.10%. Lender yields on many of those same loans (loans first disbursed between January 1, 2000 and April 1, 2006) adjust quarterly based on the 90-day AA CP rate plus a spread of between 1.74% and 2.64%, however, the borrower rate serves as the “floor” for the lender yield. Loans first disbursed in these time periods can only earn positive special allowance due to the “floor” income feature. However, for loans first disbursed after April 1, 2006 federal law changed, removing the “floor” income feature, which allows the lender yield to float down below the borrower rate. In these situations the loan owner earns less than the borrower pays in interest causing negative special allowance, which must be rebated to the U. S. Department of Education. This situation was magnified by additional change in federal law that implemented fixed borrower interest rates from 6.8% to 8.5% for loans first disbursed after July 1, 2006. Furthermore for loans first disbursed after October 1, 2007, the spread lender’s receive over the CP rate was reduced by 40 to 70 basis points. The Authority’s total special allowance was negative in fiscal 2011 and 2010 due the Authority’s loan portfolio mix and the decline in the CP rate.

**Student Loans Receivable Available for Sale** — Loans classified as student loans receivable available for sale are loans which have been placed into the Ensuring Continued Access to Student Loan Act of

2008 (ECASLA) Participation Program or were purchased with the intent to place the loans into the ECASLA Participation Program. Student loans that are placed into the ECASLA Participation Program must be either refinanced by the Authority or sold to the Department of Education under the Purchase Program by the end of the program year. As was the intent of the Authority, Participation Program loans were sold to the Department under the Purchase Program.

**Allowance for Doubtful Loans** — The Authority has established an allowance for doubtful loans that is an estimate of probable losses incurred in the FFELP and supplemental loan portfolios at the statements of net assets date. The Authority presents student loans net of the allowance on the statements of net assets. Estimated probable losses are expensed through the provision for loan losses in the period that the loss event occurs. Estimated probable losses contemplate expected recoveries. When a charge-off event occurs, the carrying value of the loan is charged to the allowance for doubtful loans. The amount attributable to expected recoveries remains in the allowance for doubtful loans until received.

The supplemental loans in the Authority's portfolio present the greatest risk of loan loss since the loans are either self-insured or insured by a third-party as opposed to the United States Department of Education, who insures FFELP loans. As such, in evaluating the adequacy of the allowance for doubtful loans on the supplemental loan portfolio, the Authority considers several factors including the loan's insured status, the seasoning of the loan, whether the loan was to a graduate or undergraduate student, and the age of the receivable.

In 2010, the Authority's loan loss reserve methodology calculated the allowance for doubtful loans by dividing the loan portfolio into categories of similar risk characteristics based on insured status and age of the receivable. The Authority then applied default and recovery rate projections to each category.

Under the revised method implemented in fiscal 2011, the Authority calculates the default rates as a percentage of the original disbursed principal balance and the current principal balance. Then, the segmented portfolio is analyzed to determine if the loans, by repayment year, have seasoned. A seasoned loan is considered to be a loan in repayment status for 3 to 4 years, based on a maximum forbearance period of 3 years plus 270 days of aging to default. Seasoned loans are reserved at the current default rate. For unseasoned loans, the Authority estimates that an acceptable reserve range is the adjusted range created by the weighted average of the seasoned loans' original and current default rates. The rate selected as the estimated reserve rate is the midpoint of this range. An adjustment is then made to incorporate future expectations. This adjustment is used to estimate the impact of future qualitative events on the default rate. Some considerations include the unemployment rate, housing prices and interest rates. To help quantify these expectations, the default rate over the past two years is reviewed. The increase in the default rate in 2010 was approximately 1% and the increase in 2011 was approximately 2%. The Authority expects this trend to continue and believes a reasonable adjustment to the default rate to be a range of 1% to 2%. Similar to the seasoning adjustment, an estimate of the midpoint of the range is utilized in the model.

Finally, special or unique reserve adjustments are modeled to adjust for insured loans, loans with collections agencies and loans in bankruptcy sub-status. Insured loans are guaranteed up to 95% so all insured loans were analyzed separately from the uninsured alternative loan portfolio. The default rates were applied to segmented insured loans to estimate the insured loan amount that would enter default and an estimated reserve is calculated based on the Authority's loss exposure. Loans with collection agencies (in litigation sub-status) require payment of 25% of the amount collected to be paid to the collection agency as fees. Loans over 270 days are reserved at 100%. Loans in the litigation sub-status aged less than 270 days receive an additional reserve of 25% to reserve for collection fees that will be charged as payments are received.



The final adjustment is for loans in the bankruptcy sub-status. Bankruptcy loans aged over 270 days are reserved at 100%. Bankruptcy loans aged less than 270 days receive an additional reserve of 50% based on an increased likelihood of default, due to the previous bankruptcy status. Historical data is not available on which to base the additional bankruptcy reserve; therefore, the additional reserve is an estimate based on an increased likelihood of falling into litigation status, a 25% additional reserve, and re-entry into bankruptcy which could result in a 100% reserve. Supplemental loan principal is charged off against the allowance when the loan exceeds 270 days delinquency. Subsequent recoveries on loans charged off are recorded directly to the allowance based on the total principal outstanding.

The Authority previously utilized true write-offs experienced over the three preceding years to estimate the current year allowance on the FFELP loans. However, due to the recent increase in defaults the Authority changed its methodology for fiscal 2011 to instead utilize only fiscal 2011 defaults multiplied by three to estimate the current year allowance on FFELP loans. Up to 98% of the principal and interest within the Authority's FFELP loan portfolio is conditionally guaranteed by the Department of Education.

Changes in the allowance methodology during fiscal 2011 resulted in approximately \$9,436 of additional allowance. Increasing default rates resulted in approximately \$9,183 of additional allowance resulting in a total provision for loan losses of \$18,619.

The allowance associated with the accrued interest receivable on student loans represents an allowance on the interest receivable on the supplemental loan portfolio consistent with the allowance for doubtful loans on the supplemental loan portfolio described above.

**Miscellaneous Receivables and Prepaid Expenses** — Miscellaneous receivables and prepaid expenses consist primarily of prepaid bond interest expense, receivables for servicing fees, and prepaid letter of credit fees.

**Deferred Charges** — Deferred charges consist of bond issuance costs. Deferred charges are amortized over the life of the bonds using a method that produces substantially the same results as the effective interest method.

**Capital Assets** — Capital assets consist of land, building, office furniture and equipment, and software assets recorded at cost. The Authority's policy is to capitalize all expenditures in excess of \$10. Depreciation is charged to operations on the straight-line method over the estimated useful lives of the related assets, which is 30 years for the building and generally five years for all other asset classes. The Authority reviews capital assets for impairment in accordance with GASB Codification 1400, *Reporting Capital Assets*.

**Arbitrage Rebate** — Federal income tax rules limit the investment and loan yields which the Authority may retain for its own use when investing the proceeds from certain of its tax-exempt bond issues. The excess investment and loan yields are payable to the U.S. Treasury and are accrued in the accompanying statements of net assets. Excess loan yields may also be reduced by certain borrower benefit programs.

**Net Assets** — The net assets of the Authority are classified into three categories: unrestricted, restricted and invested in capital assets. Unrestricted net assets include net assets available for the operations of the Authority and other activities accounted for in either the Operating Fund or the Bond Funds. Unrestricted net assets accounted for in the Bond Funds are pledged and subject to the requirements of the Bond Funds in which those unrestricted net assets are maintained. Removal of unrestricted net assets from the Bond Funds are typically subject to the approval of one or more of the following: credit rating agencies, bond insurers, letter of credit providers, bondholders and/or the trustee. Furthermore, extensive

financial analysis is required and performed by the Authority and the approving party prior to the approval and removal of net assets. Restricted net assets consist of the minimum collateral requirements discussed in Note 7, net of related liabilities, as defined in the bond resolutions.

**Operating Revenues and Expenses** — While bond and note issuance has historically been the principal source of the funds necessary to carry out the purposes of the Authority, which are to originate and acquire student loans, during the last two years the Authority has relied extensively on Federal ECASLA programs to carry out its purpose. The Authority's revenue is derived primarily from income on student loans and results on the extinguishment of outstanding bonds payable. Secondary sources of revenue include subsidies from fees associated with ECASLA programs, servicing fee revenue, and investment income. The primary cost of the program is interest expense on bonds and other borrowings outstanding. Therefore loan income, net investment income and interest expense are shown as operating revenues and expenses in the statements of revenues, expenses, and changes in net assets.

**Gain on Extinguishment of Debt** — Gains on extinguishment of debt represents the net result of the Authority's efforts to purchase and extinguish previously issued bonds utilizing excess cash held under the 11<sup>th</sup> and 12<sup>th</sup> General Resolutions. Gains resulting from the purchase and extinguishment of bonds at a discount to carrying value are off-set by the write-off of previously unamortized bond issuance costs and premiums on the purchased bonds.

**ECASLA Income** — In August 2008, the Department of Education implemented the Purchase Program pursuant to ECASLA. Under the Purchase Program, the Department of Education purchases eligible FFELP loans at a price equal to the sum of (i) par value, (ii) accrued interest, (iii) the one-percent origination fee paid to the Department of Education, and (iv) a fixed amount of \$75 per loan. ECASLA income is earned from the Purchase Program.

**Servicing Fee Revenue** — The Authority provides services to lending institutions for guarantee processing, loan origination, loan disbursement and loan servicing with respect to student loans. Fees charged for these services are classified as Servicing Fee.

**Interest Expense** — Interest expense primarily includes scheduled interest payments on bonds and other borrowings as well as broker commission fees, repricing fees, auction agent fees, and cost of issuance amortization.

**Consolidation Fees** — The Authority must remit each month to the U.S. Department of Education (the "Department") an interest payment rebate fee for all of its Federal consolidation loans made on or after October 1, 1993. This fee is equal to 1.05% per annum of the unpaid principal balance and accrued interest of the loans. For loans made from applications received during the period beginning October 1, 1998 through January 31, 1999, inclusive, this fee is equal to 0.62% per annum of the principal and accrued interest of the loans. This fee is not and cannot be charged to the borrower.

**Origination Fees** — The Department charges lenders an origination fee based on the principal amount of each FFELP loan originated. The fee is paid to the Department and cannot be charged to the borrower. For loans first disbursed on or after October 1, 2007, the fee is 1% of the principal loan amount.

**Bond Maintenance Fees** — Bond maintenance fees consist primarily of rating agency fees, trustee fees and custodian fees.

**Risk Management** — The Authority is exposed to various risks of loss related to property loss, torts, cyber liability, errors and omissions and employee injuries. Coverage for these various risks of loss is

obtained through commercial insurance. There has been no significant reduction in insurance coverage from coverage in the prior year for all categories of risk. Settlements have not exceeded insurance coverage for the past three fiscal years. Commercial insurance is purchased in an amount that is sufficient to cover the Authority's risk of loss. The Authority will record an estimated loss related to a loss contingency as an expense and a liability if it meets the following requirements: (1) information available before the financial statements are issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and (2) the amount of the loss can be reasonably estimated.

**Income Taxes** — The Authority is a tax-exempt organization under the provisions of the Internal Revenue Code and accordingly, no provision for income taxes has been made in the accompanying financial statements.

### **3. CASH AND CASH EQUIVALENTS**

At June 30, 2011 and 2010, the Authority's carrying amount of cash on deposit was \$57,682 and \$78,375, respectively. As of June 30, 2011, all non-interest bearing deposits are insured by the FDIC. As it relates to cash deposits held in the Authority's operating funds, the Authority's policy is that deposits should either be insured or collateralized with investments that are permissible under the Authority's state statutes. The Authority has a Tri-Party Collateral Management Agreement with Bank of America for interest bearing deposits in excess of FDIC insurance levels. Bank of New York Mellon serves as the custodian for the collateral pledged under the agreement. As of June 30, 2011, there were Federal National Mortgage Association and Federal Home Loan Mortgage Corporation mortgage backed securities with a collateral value of \$29,767 pledged against the \$29,765 in uninsured deposits. As of June 30, 2011, the uninsured deposits were collateralized by Government National Mortgage Association notes. Other security types approved by the Authority under the arrangement with Bank of America include: U.S. Treasuries, general obligation bonds of the State of Missouri, and other similar securities.

At June 30, 2011 and 2010, the Authority's cash equivalent balances of \$296,167 and \$164,346, respectively, represented investments in money market funds with credit ratings of AAAM. As of June 30, 2011, \$289,463 of the balances, which are held by the respective trustees under the Authority's bond trust estates and are uninsured and uncollateralized, are invested in accordance with the investment securities provisions of the respective trust estates. In addition, as of June 30, 2011, the Authority had \$6,704 of uninsured and uncollateralized operating fund cash equivalents in unrated money market funds.

### **4. INVESTMENTS HELD BY TRUSTEE**

State law limits investments to any obligations of the State of Missouri or of the United States government, or any instrumentality thereof, certificates of deposit or time deposits of federally insured banks, or federally insured savings and loan associations, or of insured credit unions, or with respect to moneys pledged or held under a trust estate or otherwise available for the owners of bonds or other forms of indebtedness, any investment authorized under the bond resolution governing the security of payment of such obligations or repurchase agreements for the specified investments.

While the bond investment securities provisions vary by trust estate, investments generally may include U.S. Treasury obligations, and certain of the following based on maturity and rating: U.S. Government Agency and Sponsored agency obligations, bank deposits, repurchase agreements, reserve repurchase agreements, investment agreements, guaranteed investment contracts, money market funds, commercial paper, and tax-exempt bonds.

As of June 30, 2011 and 2010, the Authority held no investments.

**5. STUDENT LOANS RECEIVABLE**

Student loans receivable are insured namely by the Missouri Department of Higher Education (MDHE), American Education Services (AES), the Student Loan Guarantee Foundation of Arkansas (SLGFA), United Student Aid Funds, Inc. (USA Funds), the National Student Loan Program (NSLP), the California Student Aid Commission (CSAC), the Tennessee Student Assistance Corporation (TSAC), the American Student Assistance (ASA), the Kentucky Higher Education Assistance Authority (KHEAA), the New York State Higher Education Services Corporation (NYSHESC), the Texas Guaranteed Student Loan Corporation (TGSLC), the Illinois Student Assistance Commission (ISAC), the Educational Credit Management Corporation (ECMC), the Northwest Education Loan Association (NELA), the Great Lakes Higher Education Corporation (GLHEC), or by other non-profit or state organizations, as to principal and accrued interest to the fullest extent allowed under current law. The supplemental loans are not federally insured.

Student loans receivable at June 30, 2011 and 2010, are as follows:

	<b>2011</b>	<b>2010</b>
Total federally insured loans	<u>\$3,601,558</u>	<u>\$4,014,124</u>
Supplemental loans:		
Third party insured	11,808	14,982
Self-insured	<u>186,454</u>	<u>211,547</u>
Total supplemental loans	198,262	226,529
Allowance for doubtful loans	<u>(23,368)</u>	<u>(10,901)</u>
Total student loans receivable	<u>\$3,776,452</u>	<u>\$4,229,752</u>
Weighted average yield paid by students — end of year	<u>5.08 %</u>	<u>5.62 %</u>

The Authority's yield on federal student loan receivables is set by federal law and is generally variable based on either 90-day AA CP rate or the 91-day Treasury bill, plus a factor. These yields are based on the type of loan, the date of loan origination and in some cases, the method of financing. Consolidation loans, Stafford loans, and Parental Loans for Undergraduate Students (PLUS loans), originated after July 1, 2006, have a fixed rate for the borrower. The Authority's yield on supplemental loans are variable rate, based on either the Treasury bill or the prime rate, plus a factor, depending on when the loan originated and the credit worthiness of the borrower and/or co-signor.

The activity for the allowance for doubtful loans for the years ended June 30, 2011 and 2010, is as follows:

	<b>2011</b>	<b>2010</b>
Beginning balance	\$ 10,901	\$ 6,158
Provision for loan losses	18,619	8,001
Write offs of loans	(7,065)	(3,426)
Recoveries	<u>913</u>	<u>168</u>
	<u><b>\$ 23,368</b></u>	<u><b>\$ 10,901</b></u>

## 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2011, is as follows:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Retirements</b>	<b>Ending Balance</b>
Land	<u>\$ 3,304</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,304</u>
Depreciable capital assets:				
Building	12,060	742		12,802
Furniture and equipment	5,868	2,835	(2,198)	6,505
Software assets	<u>          </u>	<u>516</u>	<u>          </u>	<u>516</u>
Total depreciable capital assets	<u>17,928</u>	<u>4,093</u>	<u>(2,198)</u>	<u>19,823</u>
Less accumulated depreciation:				
Building	3,261	433		3,694
Furniture and equipment	<u>3,926</u>	<u>821</u>	<u>(2,172)</u>	<u>2,575</u>
	<u>7,187</u>	<u>1,254</u>	<u>(2,172)</u>	<u>6,269</u>
Net depreciable capital assets	<u>10,741</u>	<u>2,839</u>	<u>(26)</u>	<u>13,554</u>
Total	<u><b>\$ 14,045</b></u>	<u><b>\$ 2,839</b></u>	<u><b>\$ (26)</b></u>	<u><b>\$ 16,858</b></u>

Capital asset activity for the year ended June 30, 2010, is as follows:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Retirements</b>	<b>Ending Balance</b>
Land	<u>\$ 3,304</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,304</u>
Depreciable capital assets:				
Building	11,972	88		12,060
Furniture and equipment	<u>5,046</u>	<u>863</u>	<u>(41)</u>	<u>5,868</u>
Total depreciable capital assets	<u>17,018</u>	<u>951</u>	<u>(41)</u>	<u>17,928</u>
Less accumulated depreciation:				
Building	2,844	417		3,261
Furniture and equipment	<u>3,296</u>	<u>663</u>	<u>(33)</u>	<u>3,926</u>
	<u>6,140</u>	<u>1,080</u>	<u>(33)</u>	<u>7,187</u>
Net depreciable capital assets	<u>10,878</u>	<u>(129)</u>	<u>(8)</u>	<u>10,741</u>
Total	<u>\$ 14,182</u>	<u>\$ (129)</u>	<u>\$ (8)</u>	<u>\$ 14,045</u>

## 7. BONDS PAYABLE

The following table displays the aggregate changes in bonds payable for fiscal years ended June 30:

	<b>2011</b>	<b>2010</b>
Beginning bonds payable	\$ 3,498,972	\$ 3,879,200
Additions	495,200	1,769,900
Repayments	(254,986)	(51,405)
Bonds purchased and subsequently extinguished	<u>(71,325)</u>	<u>(2,098,723)</u>
Ending bonds payable	<u>\$ 3,667,861</u>	<u>\$ 3,498,972</u>

Bonds payable at June 30 consist of:

	<b>2011</b>	<b>2010</b>
Student loan revenue bonds, variable interest rates ranging from 0% to 4.42% at June 30, 2011, and 0% to 4.37% at June 30, 2010, maturing through 2046	<u>\$ 3,667,861</u>	<u>\$ 3,498,972</u>
Weighted average rate for the year	<u>1.02 %</u>	<u>1.12 %</u>

The following is a summary of debt service requirements at June 30:

<b>Fiscal Years</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2012	\$ 171,160	\$ 29,720	\$ 200,880
2013	156,589	27,843	184,432
2014	163,828	26,009	189,837
2015	166,082	24,120	190,202
2016	<u>163,805</u>	<u>22,231</u>	<u>186,036</u>
Total fiscal years 2012–2016	821,464	129,923	951,387
2017–2021	1,454,683	74,498	1,529,181
2022–2026	480,664	47,520	528,184
2027–2031	309,069	33,116	342,185
2032–2036	102,731	16,469	119,200
2037–2041	21,000	14,755	35,755
2042–2046	<u>478,250</u>	<u>11,207</u>	<u>489,457</u>
	<u>\$ 3,667,861</u>	<u>\$ 327,488</u>	<u>\$ 3,995,349</u>

At June 30, 2011, variable student loan revenue bonds consist of tax-exempt variable rate demand notes totaling \$262,500, taxable auction rate notes totaling \$539,950, tax-exempt auction rate notes totaling \$135,700, LIBOR indexed rate notes (LIRNs) totaling \$750,000 and LIBOR floating rate notes totaling \$1,979,711. Variable rate demand notes, which represent 7% of the outstanding variable rate bonds, bear interest at a rate determined by the remarketing agent. Such rate is determined every 7 days. The remarketing agent is authorized to use its best efforts to sell the repurchased bonds at a price equal to 100% of the principal amount by adjusting the interest rate. The repricing fee is expensed as incurred and included within interest expense on the statements of revenues, expenses, and changes in net assets. Auction rate notes, which represent 18% of the outstanding variable rate bonds, bear interest at the applicable auction rate as determined by a bidding process every 7, 28, or 35 days as stipulated in the related Bond Agreement. Starting in November 2007 and continuing through June 30, 2011, the auction rate notes experienced failures in the bidding process. The auction rate notes are not putable. As of June 30, 2011, due to the failures in the auction market, the interest rate was calculated based upon the rate provisions as stipulated in the Bond Agreements and amended by supplemental resolutions agreed to by the Authority. The interest rates continued to reprice every 7, 28 or 35 days under a failed auction but were determined based upon a 91-Day Treasury Bill (T-Bill) indexed rate for taxable debt or a JJ Kenny indexed rate for tax-exempt debt taken in consideration with the annual average auction rate as of the current repricing date. The Authority's LIRN, which represents 20% of the outstanding variable rate bonds, reprice monthly based on one month LIBOR plus 13 basis points. The Authority also has four outstanding LFRN trusts representing 54% of the outstanding variable rate bonds that reprice every three months at spreads to three month LIBOR ranging from 60 to 105 basis points. The debt service requirements in the table above were prepared using the applicable variable rates on June 30, 2011, and may significantly differ from the rates paid in future periods.

Certain bonds are subject to redemption or rate period adjustment at the discretion of the Authority under certain conditions as set forth in the Bond Agreement. In addition, at June 30, 2011, \$214,550 of the bonds are subordinate to the remainder of the outstanding bonds.

Bonds of each series are secured by (a) a pledge of proceeds derived from the sale of the bonds, (b) eligible loans, and (c) certain accounts established by the respective bond resolutions, including

moneys and securities therein. For certain bonds, the Authority has entered into agreements with the Municipal Bond Investors Assurance Corporation, Bank of America N.A., and AMBAC Indemnity, whereby the parties have issued standby bond purchase agreements, letters of credit, or insurance policies to the Trustees as beneficiaries for the respective bondholders. The purpose of the standby bond purchase agreements, letters of credit or insurance policies is to provide liquidity to bondholders, and or guarantee payment of the bonds upon maturity or earlier redemption. The agreements contain certain covenants which, among other requirements, include minimum collateral requirements. The Authority maintains a minimum amount of assets pledged under required bond resolutions. The total of all minimum requirements for all bond issuances at June 30, 2011 and 2010, is \$3,909,757 and \$3,672,652, respectively. At June 30, 2011 and 2010, the Authority was in compliance with all financial covenants except its covenant within the 12<sup>th</sup> General Resolution requiring that the value of supplemental loans under the Resolution not exceed 75% of the value of all student loans under the Resolution, which was 77.3% and 76.1% at June 30, 2011 and 2010 respectively. While there are potential remedies that the bond insurer could take, to date, the Authority has not received any oral or written confirmation from the bond insurer indicating that they will be taking further action on this violation.

The respective bond resolutions establish the following special trust accounts for each bond series, unless otherwise indicated:

**Loan Accounts** — The loan accounts are used to account for the proceeds of bond issues not required to be deposited in the debt service reserve accounts. Generally, amounts in the loan accounts may be expended (a) to finance eligible student loans, (b) to pay bond issue costs, (c) to make deposits to the revenue accounts for the purpose of paying principal and/or interest on the bonds, and (d) to pay letter of credit fees.

**Revenue Accounts** — The revenue accounts are used to account for all revenues received by the Authority. Generally, amounts in the revenue accounts are used (a) to make principal and/or interest payments on the bonds, (b) to fund debt service reserve accounts, (c) to pay estimated program expenses to the operating account, and (d) to reimburse the issuers of letters of credit guaranteeing the bonds for amounts committed under the letters of credit. Excess amounts in the revenue account may be transferred to the loan accounts or to optional redemption accounts.

**Operating Accounts** — Amounts deposited in operating accounts are used to pay reasonable and necessary program expenses for the bond issues.

**Debt Service Reserve Accounts** — Under the terms of certain bond provisions, minimum amounts are required to be maintained in the debt service reserve accounts for related bond series. The total of these minimum requirements at June 30, 2011 and 2010, were \$5,690 and \$6,001, respectively. These funds are only to be used to make principal and/or interest payments on the bonds and any interest due on the borrowed funds. In accordance with the bond provisions, the Authority has purchased a non-cancelable Surety Bond in lieu of cash deposits in the debt service reserve accounts for certain of the bond obligations in the amount of \$5,580 and \$5,756 at June 30, 2011 and 2010, respectively. Such Surety Bonds expire on the earlier of the bond maturity date or the date in which the Authority satisfies all required payments related to such bond obligations. Under the ECASLA Federal Loan Participation Purchase Program funds received in the account are owed directly to the Department to pay principal and interest.

**Rebate Accounts** — Amounts deposited in the rebate accounts are used to pay the United States Treasury amounts required by Section 148 of the Internal Revenue Code.



The LFRNs issued in the 2009-1, 2010-1, 2010-2, and 2010-3 Trusts establish the following special trust accounts:

**Collection Fund** — Used to pay servicing administration fees, consolidated rebate fees, trustee fees, debt service, and make principal payments. Funds can also be used to re-instate the Reserve and Department Rebate Fund Accounts as required.

**Reserve Accounts** — Under the terms of certain bond provisions, minimum amounts are required to be maintained in the reserve accounts for related bond series. The total of these minimum requirements at June 30, 2011 and 2010, respectively, was \$4,949 and \$4,349.

**Capitalized Interest Funds** — Used to pay certain service, administrative, and other fees not available to be paid from the Collection Account.

**Rebate Accounts** — Used to pay negative special allowance and consolidation rebate fees.

**Acquisition Funds** — Used initially to account for loans transferred to the trust and or pay cost of issuance due within sixty days of closing.

The Straight-A Conduit establishes the following accounts:

**Collateral Accounts** — Amounts deposited in this account are used to make payments for purchases of delinquent loans and associated special allowance.

**Rebate Accounts** — Amounts deposited in this account are used to make payments for negative special allowance.

**Reserve Accounts** — Under the terms of the Straight-A Conduit Program certain amounts are required to be maintained in the Reserve Account equal to 1% of the principal balance of the financed student loans.

**Collection Accounts** — The Collection Account is used to account for receipt of borrower payments, pay financing costs, servicing fees, principal and to fund the Department Reserve Account for special allowance payments.

As of June 30, 2011 and 2010, cash and cash equivalents were segregated as follows:

	<b>2011</b>	<b>2010</b>
Special trust accounts:		
Unrestricted:		
Collection fund	\$ 4,500	\$ 4,613
Revenue accounts	174,771	66,115
Operating accounts	3,231	3,274
Restricted:		
Debt service reserve accounts	5,690	9,341
Reserve accounts	7,613	7,442
Capitalized interest funds	15,120	18,486
Acquisition funds		142
Collection accounts	64,308	36,237
Collateral accounts	1,078	921
Rebate accounts	<u>14,229</u>	<u>5,166</u>
Total special trust accounts	<u>290,540</u>	<u>151,737</u>
Operating fund:		
Unrestricted	49,621	52,944
Due to special trust accounts	13,688	8,037
Restricted		<u>30,003</u>
Total operating fund	<u>63,309</u>	<u>90,984</u>
Total cash and cash equivalents	<u>\$ 353,849</u>	<u>\$ 242,721</u>

## 8. FINANCINGS

**Straight-A Conduit Program** — In May 2009, the Department issued the Asset-Backed Commercial Paper (ABCP) Conduit Program to help ensure the continued availability of FFELP loans to students and parents for the 2009-2010 academic year. Loans eligible for the Conduit Program include Stafford and PLUS loans with first disbursement dates on or after October 1, 2003 and no later than June 30, 2009, which are fully disbursed before September 30, 2009. The Department entered into a PUT Agreement with the Straight-A Funding LLC Conduit (“Straight A Conduit”) using the authority provided by, and consistent with the requirements of the ECASLA.

The Straight-A Conduit will purchase notes secured by eligible FFELP loans from eligible FFELP lenders and holders, which in turn will serve as the underlying asset against which the conduit sells commercial paper. The commercial paper will have variable maturities, but in no case longer than 90 days. As previously issued commercial paper matures, proceeds from newly-issued commercial paper will be used to satisfy investors holding earlier maturities. If necessary, the Federal Financing Bank will provide a short-term liquidity backstop to re-finance maturing commercial paper. The Department will purchase loans from the conduit in order to allow the conduit to repay such short-term liquidity loans to the extent required. The Straight-A Conduit provides an advance of 97 percent of the student loan value for loans in the program. The term of the Straight-A Conduit is five years and expires on November 19, 2013, however, new draws are no longer permitted. Due to the short-term nature of the commercial paper sold by the Straight-A Conduit, the Straight-A Conduit is classified as a current liability within the statement of net assets. On July 30, 2009, the Authority funded \$190,158 in loans through the Straight-A

Conduit. The Authority used this draw to refinance its multi-seller asset backed conduit that was originally entered into on July 26, 2007. On October 30, 2009, the Authority funded an additional \$118,561 in loans through the Straight-A Conduit to refinance eligible assets held under the 2005 Trust. As of June 30, 2011, the Authority had \$237,093 in borrowings outstanding under the Straight-A Conduit compared to \$282,049 in fiscal 2010.

**Conduit** — On July 26, 2007, the Authority entered into an amended financing agreement for a \$250,000 multi-seller asset backed commercial paper conduit (the “Conduit”). On November 23, 2007, the Authority amended the agreement to increase the Conduit to \$500,000. On July 24, 2008, the Authority entered into an amended financing agreement for a \$500,000 multi-seller asset backed commercial paper conduit. On October 16, 2008, the financing agreement was amended to reduce the facility limit to \$375,000. As a result of a margin call by the bank demanding more equity which the Authority could not meet, the facility was amended on December 23, 2008. The amendment reduced the facility limit to \$250,000 with a payout schedule through July 2009. On July 23, 2009, the Authority entered into an agreement to extend the termination date on the asset back commercial paper conduit to August 21, 2009, under the same terms present in the original agreement. On July 30, 2009, the asset back commercial paper conduit was paid in full.

For the years ended June 30, 2011 and 2010, the following table displays the aggregate changes in the Conduit and Straight A Conduit:

	<b>2011</b>	<b>2010</b>
Beginning balance	\$ 282,049	\$ 180,000
Additional borrowings		308,719
Repayments	<u>(44,956)</u>	<u>(206,670)</u>
Ending balance	<u>\$ 237,093</u>	<u>\$ 282,049</u>
Yield at end of year	<u>0.76%</u>	<u>1.12%</u>

**The Ensuring Continued Access to Student Loans Act — Participation and Purchase Programs** — On May 7, 2008, U.S. House Resolution 5715, the Ensuring Continued Access to Student Loans Act (ECASLA) was signed. The Act gives the U.S. Department of Education the authority to advance funds and enter into forward purchase commitments with qualifying lenders for the purchase of FFELP loans.

The Master Participation Agreement was designed to provide short-term liquidity to eligible lenders for the purpose of financing the origination of FFELP loans. Loans participated in the program were charged a rate of commercial paper plus 0.50% on the principal amount. All loans under the Participation Program had to be either refinanced by the lender or sold to the Department under the Purchase Program. This ECASLA participation line of credit for the 2009-10 program year was available to the Authority until October 15, 2010. At June 30, 2010, the Authority had \$470,596 in loans under the Participation Program, which were classified as available for sale on the statement of net assets. Loans classified as available for sale on the statement of net assets were funded through the ECASLA payable current liability on the statement of net assets. Loans classified as available for sale were sold to the Department under the Purchase Program on August 20, September 17 and October 15, 2010.

The Master Loan Sale Agreement allowed eligible lenders to sell FFELP loans originated for the 2009–2010 academic year to the Department of Education through the Purchase Program at 101% plus \$75 per loan. Any lender participating had to represent to the Department that it would continue to participate in

the FFELP program. During the year ended June 30, 2011, the Authority sold \$690,125 in loans and accrued interest to the Department under the Purchase Program compared to \$704,968 in fiscal 2010.

**Bridge Financing** — On June 24, 2009, the Authority entered into a new \$80,000 revolving line of credit with three banks to serve as a “bridge” financing for the Authority’s utilization of the ECASLA Federal Loan Participation Program. The interest rate is based on three options from which the Authority may choose: (i) Base Rate Option, based on the highest of (a) the Federal Funds Open Rate, plus 0.5%, and (b) the Prime Rate, and (c) the Daily LIBOR Rate, plus 1.0% (ii) LIBOR Rate Option, or (iii) Daily LIBOR Rate Option. Different Interest Rate Options and different Interest Periods may be selected simultaneously for the loans comprising different borrowing tranches. Unused fee on the facility is 0.25%. The line of credit, which was scheduled to expire on June 23, 2010, was terminated by the Authority on May 24, 2010 because the facility was no longer needed.

**2009-1 LIBOR Floating Rate Notes** — On November 5, 2009, the Authority issued and privately placed \$186,000 in LIBOR floating rate notes to refinance the non-Straight-A Conduit eligible assets from the 2005 Trust, which were primarily consolidation loans. The notes are Full Turbo, requiring all revenues in excess of required expenses to be used to reduce the outstanding principal balance. The notes had a starting parity of 105.44%, and were issued in two series as follows: Series A-1 for \$67,700 at three month LIBOR plus 0.60% with a expected weighted average life of 3.0 years and a final maturity of August 25, 2019, as well as, Series A-2 for \$118,300 at three month LIBOR plus 1.05% with a expected weighted average life of 10.99 years and a final maturity of February 25, 2036. The expected weighted average life was calculated based on a two percent constant prepayment rate (CPR). The 2005 Trust was a tax-exempt variable rate demand note (VRDN) backed by a synthetic letter of credit, with a standby bond purchase agreement and bond insurance. The interest rate on the VRDN was variable and prior to the credit market crisis, when the product functioned properly the remarketing rate that the bonds reset at was a rate that tracked closely with the SIFMA index (variable rate municipal bond index). Because of downgrades to the bond insurer, most of the bondholders put the bonds to the standby liquidity provider and the bonds became term bank bonds. As bank bonds, the interest rate of the bonds became a variable rate based on prime plus 1%. Given the low variable rate yield on the underlying assets and the higher cost of funds for the bonds based on prime, the trust began operating at a negative spread. These events also caused the bond maturity to change from 35 years to 5 years with mandatory semi-annual principal payments in eight equal installments beginning one year after the bonds became bank bonds. An agreement was reached among the transaction parties to restructure the failed VRDNs by financing the Straight-A Conduit eligible loans held by the trust into the Straight-A Conduit and to finance the remaining non-conduit eligible loans into the 2009-1 LIBOR floating rate notes. This transaction included a third party contribution of \$24,000. The Authority also contributed equity to the 2009-1 Trust and Straight-A Conduit from its operating fund.

**2010-1 LIBOR Floating Rate Notes** — On January 28, 2010 the Authority issued \$761,400 in LIBOR floating rate notes to pay down \$819,150 of failed auction rate bonds from the 11th General. The notes were issued in one series at three month LIBOR plus 0.95% with an expected weighted average life of 6.89 years based on a two percent CPR and a final maturity of November 26, 2032. The trust, which had a starting parity of 106.34%, permits parity releases above 110% parity. The bonds were purchased from the 11th General at a purchase price of 92% of the principal amount, with respect to the senior purchased bonds, and 87% of the principal amount with respect to the subordinate purchased bonds, plus 100% of accrued and unpaid interest. The purchase of the bonds at a discount followed by the extinguishment of the bonds creates income and overcollateralization in the 11th General Resolution. This transaction also included a third party contribution of \$750. The excess cash and loan overcollateralization was released by 11th General to the Authority operating fund and 2010-1 Trust, respectively.

**2010-2 LIBOR Floating Rate Notes** — On May 26, 2010 the Authority issued \$822,500 in LIBOR floating rate notes to pay down the \$49,820 in fixed rate bonds from the 6th General, \$33,900 in VRDNs from the 8th General and \$704,000 in failed auction rate bonds from the 11th General. The \$822,500 million in bond proceeds were also utilized to purchase loans from the Authority’s operating fund. The notes were issued in one series at three month LIBOR plus 0.85% with an expected weighted average life of 5.71 years based on a two percent CPR and a final maturity of August 27, 2029. The Full Turbo trust had a starting parity of 105.18%. The 6th and 8th General Resolutions were paid-in-full, however less than half of the remaining bonds under the 11th General Resolution were extinguished early. The bonds were extinguished early from the 11th General at a purchase price of 93.5% of principal, plus 100% of accrued and unpaid interest. As with the 2010-1 Trust, a significant amount of the income created by purchasing the bonds at a discount and extinguishing them early in the 11th General was released to the Authority’s operating fund and as in the 2010-1 Trust the income had to first be recognized by the 11th General in order for it to be released to the Authority’s operating fund and the 2010-2 Trust.

**2010-3 LIBOR Floating Rate Notes** — On September 28, 2010 the Authority issued \$495,200 in LIBOR floating rate notes to purchase over \$460,516 in loans from its lender partners and to purchase over \$22,129 in loans from the Authority’s operating fund. The notes were issued in one series at three month LIBOR plus 0.85% with an expected weighted average life of 5.94 years based on a two percent CPR and a final maturity of August 26, 2030. The Full Turbo trust had a starting parity of 105.89%.

**9. CONTRACTS, COMMITMENTS, AND CONTINGENCIES**

The Authority has three major contracts and various minor contracts to utilize electronic data processing systems and other computer services. The contracts provide for monthly charges based on the number of student loan accounts serviced, system usage and/or the amount of computer equipment supplied. The hardware rental charges ended on March 31, 2011, as the Authority is no longer renting hardware from PHEAA.

Charges incurred under the contracts for the years ended June 30, 2011 and 2010, are as follows:

	<b>2011</b>	<b>2010</b>
Charges based on loan accounts	\$ 3,076	\$ 7,138
Hardware rentals	<u>28</u>	<u>37</u>
Total	<u>\$ 3,104</u>	<u>\$ 7,175</u>

To the extent permitted under applicable law, the Authority had authorized an expenditure of a maximum of \$550 in five equal annual installments beginning July 1, 2006, to support the University of Missouri — St. Louis GEAR UP (Gaining Early Awareness and Readiness for Undergraduate Programs) Partnership (the “Partnership”), which provided need-based scholarships and grants to students seeking higher education. There were no actual expenditures under the commitment. The Authority’s commitment expired on July 1, 2010 with no installments having been paid by the Authority.

The Authority is involved, from time to time, in various claims and lawsuits incidental to the ordinary course of its business. While the ultimate outcome of litigation cannot be predicted with certainty, management, based on its understanding of the facts, does not believe the ultimate resolution of these matters will have a material adverse effect on the Authority’s financial position or results of operations.

## 10. EMPLOYEE BENEFITS

The Authority maintains a single employer defined contribution plan, the Higher Education Loan Authority of the State of Missouri 401(k) Plan (the "401(k) Plan"), with investment management performed by Goldman Sachs and recordkeeping provided by Edward Jones for all employees who are at least 21 years of age, and who work in excess of 1,000 hours per plan year, and who have been employed at least one year by the Authority. Employees may elect to defer 1% to 50% of their total compensation into the 401(k) Plan, not to exceed the limits defined in the 401(k) Plan. Sixteen investment fund options are available for choice by the employee. The Authority contributes an amount equal to 100% of the first 8% contributed by the employee. Employer matching funds are invested in the same fund choices made by the employee and are subject to a five-year vesting schedule. Some employer matching funds are offset by accumulated forfeiture credits. The Authority may make a non-matching contribution to the 401(k) Plan. The amount of this contribution, if any, will be determined by the Authority when granted. To be eligible for the contribution, an employee must be credited with at least 1,000 hours of service and be employed on the last day of the 401(k) Plan year. During fiscal 2011 and 2010, the Authority contributed \$442 and \$510 and employees contributed \$552 and \$583 to the 401(k) Plan.

The Authority offers a noncontributory defined benefit pension plan, the Higher Education Loan Authority of the State of Missouri Pension Plan (the "Pension Plan"). The Pension Plan was administered by Wells Fargo Institutional Retirement and Trust Advisors ("Wells Fargo") through June 30, 2011 but administration was transferred to PNC Institutional Investments and PNC Bank, National Association (PNC) on June 30, 2011. Employees vest in the Pension Plan after five years of service. A report of the Pension Plan may be obtained by writing to the Authority's Pension Plan Administrator, 633 Spirit Drive, Chesterfield, MO 63005-1243 or by calling (636) 532-0600 with your request for a copy of the report of the Pension Plan. The Authority has elected to recognize prior service costs over a period which represents the estimated remaining service lives of the employees at the Pension Plan and Excess Benefit Plan origination dates.

Substantially all employees of the Authority are covered by the Pension Plan. Pension benefits are based upon the employee's length of service and average compensation.

Pension Plan assets are invested primarily in debt and equity securities at the discretion of the trustee. Those securities are valued at market value. The investment objective of the Plan is to ensure that assets will be available to meet the Plan's benefit obligations. The expected return on the Plan's assets is based on the historical and anticipated returns for each asset category. At June 30, 2011, the pension funds were 100% invested in cash as the funds were transitioning from Wells Fargo to PNC. The funds were reinvested in early July and on July 31, 2011 were invested 47:47:6 debt securities to equity securities to cash. While at June 30, 2010, the allocation was 97:3 investments in common collective trusts to cash.

During the current year, the Authority contributed the actuarially determined minimum required funding. The annual required contribution for the years ended June 30, 2011, 2010, and 2009, was determined as part of the July 1, 2010, 2009, and 2008, respectively, actuarial valuations. The Authority's policy is to contribute annually not less than the actuarially determined minimum required contribution determined by using the Aggregate Actuarial Cost Method. Because this method is used, the amortization is a level percentage of payroll over the average remaining service life of active members. Separate determination and amortization of the unfunded actuarial liability are not part of such method and are not required when that method is used. There are no annual maximum contribution rates.

The following table establishes a display of the funding status measured as the ratio of Plan assets to actuarial accrued liability. This actuarial accrued liability is determined using the entry age actuarial cost

method, as required for plans that use the Aggregate Cost Method to determine the recommended contribution.

Actuarial Valuation Date	Actuarial Value of Assets Available for Benefits	Actuarial Accrued Liability (AAL)	Funded Ratio	Unfunded AAL (UAAL)	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
Pension Plan						
7/1/2010	\$22,489	\$22,077	101.9 %	\$ (412)	\$10,118	N/A
7/1/2009	18,562	20,675	89.8 %	2,113	10,708	19.7 %

The following tables detail the components of annual pension cost. The amounts recognized in the Authority's financial statements and major assumptions used to determine those amounts as of June 30, 2011, 2010, and 2009, are as follows:

	Pension Plan		
	2011	2010	2009
Net pension obligation (NPO):			
NPO — beginning of year	\$ (5,306)	\$ (5,570)	\$ (3,412)
Annual pension cost	1,810	2,280	1,878
Contributions for year	<u>(1,560)</u>	<u>(2,016)</u>	<u>(4,036)</u>
NPO — end of year	<u>\$ (5,056)</u>	<u>\$ (5,306)</u>	<u>\$ (5,570)</u>
The negative NPO represents a pension asset.			
Components of annual pension cost:			
Annual required contribution (ARC)	\$ 1,560	\$ 2,016	\$ 1,717
Interest on NPO	(371)	(389)	(239)
Adjustment to ARC	<u>621</u>	<u>653</u>	<u>400</u>
Annual Pension Cost (APC)	<u>\$ 1,810</u>	<u>\$ 2,280</u>	<u>\$ 1,878</u>
Percentage of ARC contributed	<u>100 %</u>	<u>100 %</u>	<u>235 %</u>
Major assumptions:			
Investment return	7 %	7 %	7 %
Inflation rate	4	4	4
Discount rate used for amortization of NPO	3	3	3
Salary scale	5	5	5
Amortization period (open) (years)	10.0	10.0	10.0
Cost method	Aggregate	Aggregate	Aggregate
Mortality table	1994 Group Annuity Mortality table		

## 11. STUDENT LOAN PURCHASE COMMITMENTS

In addition to the student loans already purchased at June 30, 2011, the Authority has contractual commitments to purchase \$27,032 in FFELP loans from one of its lender partners under certain agreements compared to \$64,925 on June 30, 2010. In addition, as of June 30, 2011, the Authority has contractual commitments to purchase \$26,098 in supplemental (alternative) loans from four lender partners compared to \$26,979 on June 30, 2010. As it relates to \$19,640 of the supplemental loan

commitment (3 of the 4 lender partners), if the Authority is unable to buy these loans the Authority's liability is limited to approximately \$725. The Authority also has agreements with lending institutions that require the lender to use its best efforts to make and sell student loans to the Authority up to a contractually agreed-upon amount; however, the Authority has the right to refuse the purchase. The average length of the purchase commitments is three years. Management plans to fulfill the commitments using funds held by the Trustee, funds generated through the normal financing operations of the Authority and through the use of Authority operating funds. At June 30, 2011 and 2010, the Authority was servicing \$573,075 and \$1,378,409, respectively, in student loans for these and other lending institutions.

## 12. ARBITRAGE REBATE PAYABLE

In accordance with Section 148 and the regulations thereunder of the Internal Revenue Code of 1986, as amended, the Authority is required to pay to the United States Treasury certain amounts related to the Authority's tax-exempt bond issues. The amount required to be paid represents the excess of amounts earned over the interest cost of the tax-exempt borrowings. Non-purpose rebate payments are due every fifth year and when the bonds are retired. Purpose rebate payments are due every tenth year and every fifth year thereafter during the life of each bond issue and when the bonds are retired. The rebate calculation utilizes various assumptions and allows for the selection of alternative calculation options under the Code. Management estimates at June 30, 2011 and 2010, the liability to be \$1,694 and \$4,725, respectively, which has been provided for in the financial statements, however, the ultimate liability, if any, is dependent on investment yields and bond rates in the future.

The following table displays the aggregate changes in the arbitrage rebate payable for fiscal years ended June 30:

	<b>2011</b>	<b>2010</b>
Beginning balance	\$ 4,725	\$ 14,195
Reduction of arbitrage liability	(1,947)	(670)
Payments	(716)	
Student loan forgiveness	<u>(368)</u>	<u>(8,800)</u>
Ending balance	<u>\$ 1,694</u>	<u>\$ 4,725</u>

The Authority annually employs an independent third party to prepare its arbitrage rebate calculation.

## 13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of ASC 825 *Financial Instruments*. The estimated fair value amounts have been determined by the Authority using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Authority could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.



The estimated fair values of the Authority's financial instruments are as follows:

	June 30, 2011		June 30, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and cash equivalents	\$ 353,849	\$ 353,849	\$ 242,721	\$ 242,721
Student loans receivable	3,776,452	3,776,452	4,229,752	4,229,752
Liabilities:				
Conduit payable	\$ 237,093	237,093	\$ 282,049	282,049
Bonds payable	3,667,861	3,667,861	3,498,972	3,498,972
ECASLA payable			468,817	468,817
Off-balance sheet instruments — standby letters of credit	\$ -	\$ 5,602	\$ -	\$ 5,436

**Cash and Cash Equivalents** — For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value based on the short-term nature of the security.

**Student Loans Receivable** — Loans are categorized by repayment type (in-school, grace, repayment, and delinquent). The fair value is estimated using the Authority's current pricing policies and the present value of the future cash flow stream. Due to the variable rates of the Authority's student loan receivable portfolio, the carrying value of the portfolio approximates the estimated fair value at June 30, 2011 and June 30, 2010. Estimated fair value approximates the amount for which similar loans could currently be purchased on the open market.

**ECASLA Payable** — For the ECASLA payable, the carrying value is a reasonable estimate of fair value as the maturity of the instrument is less than one year.

**Conduit Payable** — For the conduit payable, the carrying value is a reasonable estimate of fair value as the line of credit has a variable rate.

**Bonds Payable** — For variable rate bonds, the carrying amount is a reasonable estimate of fair value. There were no fixed rate bonds outstanding at June 30, 2011 and June 30, 2010.

**Standby Letters of Credit** — The fair value is based on fees currently charged for similar agreements at the reporting date. On July 19, 2011, the Authority redeemed the 2008 Trust bonds in full, which resulted in the closing of the 2008 Letter of Credit that represented \$2,749 of the \$5,602 noted above as the fair value of the standby letters of credit.

#### 14. SEGMENT INFORMATION

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds or other financing is outstanding. A segment has a specific identifiable revenue stream pledged in support of the related debt and has related expenses, gains and losses, assets, and liabilities that are required by an external party to be accounted for separately. At June 30, 2011, the Authority has 10 segments that meet the reporting requirements of GASB Statement No. 34.

The outstanding debt of the Authority consists of Student Loan Revenue Bonds, the Federal ECASLA Loan Participation program, and the Straight-A Commercial paper Conduit. The Student Loan Revenue Bonds are issued in accordance with two separate General Student Loan Program Bond Resolutions

adopted by the Board of Directors in various years from 1994 through 2007, as well as in accordance with five Trust Indentures (collectively the “trust estates”) adopted by the Board of Directors from fiscal years 2009 through fiscal 2011. The bond documents provide that the bonds are payable exclusively from the eligible loans pledged under the respective Resolutions and Indentures, amounts deposited in the accounts pledge under the Resolutions and Indentures and all other revenues and recoveries of principal from the loans purchased with the bond proceeds. All of the Authority’s bonds are limited obligations of the Authority, which are payable solely from the respective trust estates. As a result, there is no cross collateralization with other trust estates and/or the operating funds of the Authority. In the case of five of the seven trust estates, bondholders have no recourse against any party, including the Authority, if the trust estate is insufficient for repayment of the notes. In the case of the other two trust estates, bondholders have no recourse against the Authority but they do have recourse to the 12<sup>th</sup> General bond insurer and/or the 2008 Trust letter of credit provider as to the payment of principal and interest on the bonds if they hold bonds issued under those trusts. Furthermore, the Authority’s bonds are not insured or guaranteed by any government agency or instrumentality, including the Authority, the State of Missouri, or any political subdivision thereof. As a result of the proceeding, it is possible that a segment can show a negative restricted net assets balance for a trust estate related segment as no operating funds of the Authority will pay the deficit.

Administrative transactions not directly associated with the purchase of and revenue streams related to student loans are recorded in the Operating Fund.

Summary financial information for the Student Loan Revenue Bonds as of June 30, 2011 and 2010, are as follows:

Condensed Statements of Net Assets	2011										
	Bond Funds					Operating Fund					Total
	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	2010-3 Trust Indenture		
Assets:											
Current assets	\$ 262,711	\$ 70,715	\$ 34,721	\$ 35,726	\$ -	\$ 19,249	\$ 106,695	\$ 117,752	\$ 72,828	\$ 64,713	\$ 785,110
Long-term assets	<u>930,561</u>	<u>207,311</u>	<u>250,939</u>	<u>214,701</u>	<u>-</u>	<u>157,835</u>	<u>600,401</u>	<u>657,042</u>	<u>422,060</u>	<u>36,685</u>	<u>3,477,535</u>
Total assets	<u>\$1,193,272</u>	<u>\$ 278,026</u>	<u>\$285,660</u>	<u>\$250,427</u>	<u>\$ -</u>	<u>\$177,084</u>	<u>\$707,096</u>	<u>\$774,794</u>	<u>\$494,888</u>	<u>\$101,398</u>	<u>\$4,262,645</u>
Liabilities:											
Current liabilities	\$ 12,809	\$ 971	\$ 4,235	\$ 239,418	\$ -	\$ 11,324	\$ 66,423	\$ 75,078	\$ 45,217	\$ 3,103	\$ 458,578
Long-term liabilities	1,139,694	287,650	262,500	-	-	151,701	586,937	651,047	418,866	-	3,498,395
Interfund payable (receivable)	<u>(9,354)</u>	<u>(1,880)</u>	<u>(973)</u>	<u>(213)</u>	<u>-</u>	<u>(188)</u>	<u>(1,276)</u>	<u>(2,071)</u>	<u>(1,093)</u>	<u>17,048</u>	<u>-</u>
Total liabilities	<u>1,143,149</u>	<u>286,741</u>	<u>265,762</u>	<u>239,205</u>	<u>-</u>	<u>162,837</u>	<u>652,084</u>	<u>724,054</u>	<u>462,990</u>	<u>20,151</u>	<u>3,956,973</u>
Net assets (deficit):											
Invested in capital assets	-	-	-	-	-	-	-	-	-	16,858	16,858
Restricted	34,202	(8,715)	15,809	11,222	-	14,247	55,012	50,740	31,898	-	204,415
Unrestricted	<u>15,921</u>	<u>-</u>	<u>4,089</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>64,389</u>	<u>84,399</u>
Total net assets (deficit)	<u>50,123</u>	<u>(8,715)</u>	<u>19,898</u>	<u>11,222</u>	<u>-</u>	<u>14,247</u>	<u>55,012</u>	<u>50,740</u>	<u>31,898</u>	<u>81,247</u>	<u>305,672</u>
Total liabilities and net assets (deficit)	<u>\$1,193,272</u>	<u>\$ 278,026</u>	<u>\$285,660</u>	<u>\$250,427</u>	<u>\$ -</u>	<u>\$177,084</u>	<u>\$707,096</u>	<u>\$774,794</u>	<u>\$494,888</u>	<u>\$101,398</u>	<u>\$4,262,645</u>

## 2010

Condensed Statements of Net Assets	Bond Funds												Operating Fund	Total
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture		
Assets:														
Current assets	\$ -	\$ -	\$ 195,660	\$ 53,764	\$ -	\$ 32,271	\$ 40,232	\$475,089	\$ -	\$ 20,834	\$112,588	\$114,801	\$100,869	\$ 1,146,108
Long-term assets	-	-	1,056,715	261,666	-	252,854	258,796	22	-	172,906	686,192	757,441	32,097	3,478,689
Total assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,252,375</u>	<u>\$315,430</u>	<u>\$ -</u>	<u>\$285,125</u>	<u>\$299,028</u>	<u>\$475,111</u>	<u>\$ -</u>	<u>\$193,740</u>	<u>\$798,780</u>	<u>\$872,242</u>	<u>\$132,966</u>	<u>\$4,624,797</u>
Liabilities:														
Current liabilities	\$ -	\$ -	\$ 17,743	\$ 1,640	\$ -	\$ 4,235	\$284,623	\$479,963	\$ -	\$ 11,913	\$ 70,344	\$ 76,337	\$ 3,347	\$ 950,145
Long-term liabilities	-	-	1,204,900	296,798	-	262,502	-	-	-	168,040	677,394	749,908	-	3,359,542
Interfund payable (receivable)	-	-	(9,987)	(1,910)	-	(740)	(189)	(6,484)	-	(146)	(2,228)	(2,640)	24,324	-
Total liabilities	<u>-</u>	<u>-</u>	<u>1,212,656</u>	<u>296,528</u>	<u>-</u>	<u>265,997</u>	<u>284,434</u>	<u>473,479</u>	<u>-</u>	<u>179,807</u>	<u>745,510</u>	<u>823,605</u>	<u>27,671</u>	<u>4,309,687</u>
Net assets:														
Invested in capital assets	-	-	-	-	-	-	-	-	-	-	-	-	14,045	14,045
Restricted	-	-	35,429	3,902	-	15,817	14,594	1,632	-	13,933	53,270	48,637	30,000	217,214
Unrestricted	-	-	4,290	15,000	-	3,311	-	-	-	-	-	-	61,250	83,851
Total net assets	<u>-</u>	<u>-</u>	<u>39,719</u>	<u>18,902</u>	<u>-</u>	<u>19,128</u>	<u>14,594</u>	<u>1,632</u>	<u>-</u>	<u>13,933</u>	<u>53,270</u>	<u>48,637</u>	<u>105,295</u>	<u>315,110</u>
Total liabilities and net assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,252,375</u>	<u>\$315,430</u>	<u>\$ -</u>	<u>\$285,125</u>	<u>\$299,028</u>	<u>\$475,111</u>	<u>\$ -</u>	<u>\$193,740</u>	<u>\$798,780</u>	<u>\$872,242</u>	<u>\$132,966</u>	<u>\$4,624,797</u>

Condensed Statements of Revenues, Expenses and Changes in Net Assets	2011										
	Bond Funds										
	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	2010-3 Trust Indenture	Operating Fund	Total
Operating revenues	\$34,146	\$ 14,366	\$ 7,136	\$ 5,632	\$ 1,991	\$ 5,429	\$ 20,742	\$ 22,080	\$ 8,518	\$ 8,337	\$ 128,377
Operating expenses	24,198	23,838	6,345	3,788	896	5,086	18,883	19,846	9,149	25,786	137,815
Operating (loss) income	9,948	(9,472)	791	1,844	1,095	343	1,859	2,234	(631)	(17,449)	(9,438)
Interfund transfers	456	(18,145)	(21)	(5,216)	(2,727)	(29)	(117)	(131)	32,529	(6,599)	-
Increase (decrease) in net assets (deficit)	10,404	(27,617)	770	(3,372)	(1,632)	314	1,742	2,103	31,898	(24,048)	(9,438)
Net assets — beginning of year	39,719	18,902	19,128	14,594	1,632	13,933	53,270	48,637	-	105,295	315,110
Net assets — end of year	\$50,123	\$ (8,715)	\$ 19,898	\$ 11,222	\$ -	\$ 14,247	\$ 55,012	\$ 50,740	\$ 31,898	\$ 81,247	\$ 305,672

Condensed Statements of Revenues, Expenses and Changes in Net Assets	2010													
	Bond Funds													
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	Operating Fund	Total
Operating revenues	\$ (56)	\$ 435	\$171,061	\$19,721	\$ 25,348	\$ 7,096	\$ 5,740	\$4,169	\$ 66	\$ 3,783	\$ 9,483	\$ 2,110	\$ 15,527	\$264,483
Operating expenses	2,362	(466)	58,288	9,416	6,870	6,234	3,882	2,091	725	3,556	8,740	2,451	13,631	117,780
Operating (loss) income	(2,418)	901	112,773	10,305	18,478	862	1,858	2,078	(659)	227	743	(341)	1,896	146,703
Interfund transfers	(3,848)	(967)	(155,544)	(25)	(5,698)	4	(14,200)	(422)	(2,865)	13,706	52,527	48,978	68,354	-
Increase (decrease) in net assets	(6,266)	(66)	(42,771)	10,280	12,780	866	(12,342)	1,656	(3,524)	13,933	53,270	48,637	70,250	146,703
Net assets (deficit) — beginning of year	6,266	66	82,490	8,622	(12,780)	18,262	26,936	(24)	3,524	-	-	-	35,045	168,407
Net assets — end of year	\$ -	\$ -	\$ 39,719	\$18,902	\$ -	\$19,128	\$ 14,594	\$1,632	\$ -	\$13,933	\$53,270	\$48,637	\$105,295	\$315,110

2011														
Bond Funds														
Condensed Statements of Cash Flow	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	2010-3 Trust Indenture	Operating Fund	Total			
Net cash flows from operating activities	\$ 150,042	\$ 35,011	\$ 857	\$ 44,186	\$ 503,913	\$ 18,749	\$ 104,958	\$ 126,399	\$(426,586)	\$(56,737)	\$ 500,792			
Net cash flows from non-capital financing activities	(67,336)	(13,196)	(1,090)	(45,714)	(507,240)	(18,957)	(99,816)	(115,208)	449,831	33,097	(385,629)			
Net cash flow from capital activities	-	-	-	-	-	-	-	-	-	(4,035)	(4,035)			
Net increase (decrease) in cash and cash equivalents	82,706	21,815	(233)	(1,528)	(3,327)	(208)	5,142	11,191	23,245	(27,675)	111,128			
Cash and cash equivalents — beginning of year	66,477	7,904	5,023	9,550	3,327	7,564	28,137	23,755	-	90,984	242,721			
Cash and cash equivalents — end of year	\$ 149,183	\$ 29,719	\$ 4,790	\$ 8,022	\$ -	\$ 7,356	\$ 33,279	\$ 34,946	\$ 23,245	\$ 63,309	\$ 353,849			

  

2010														
Bond Funds														
Condensed Statements of Cash Flow	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	Operating Fund	Total
Net cash flows from operating activities	\$ 51,861	\$ 37,918	\$ 1,545,515	\$ 32,793	\$ 324,100	\$ 3,148	\$(96,935)	\$(181,798)	\$(3,201)	\$(167,113)	\$(704,230)	\$(792,774)	\$ 65,080	\$ 114,364
Net cash flows from non-capital financing activities	(52,399)	(39,204)	(1,554,890)	(41,564)	(331,741)	(1,483)	100,587	181,171	-	174,677	732,367	816,529	(117)	(16,067)
Net cash flow from capital activities	-	-	-	-	-	-	-	-	-	-	-	-	(939)	(939)
Net increase (decrease) in cash and cash equivalents	(538)	(1,286)	(9,375)	(8,771)	(7,641)	1,665	3,652	(627)	(3,201)	7,564	28,137	23,755	64,024	97,358
Cash and cash equivalents — beginning of year	538	1,286	75,852	16,675	7,641	3,358	5,898	3,954	3,201	-	-	-	26,960	145,363
Cash and cash equivalents — end of year	\$ -	\$ -	\$ 66,477	\$ 7,904	\$ -	\$ 5,023	\$ 9,550	\$ 3,327	\$ -	\$ 7,564	\$ 28,137	\$ 23,755	\$ 90,984	\$ 242,721

## 15. SUBSEQUENT EVENTS

**Access Missouri and Advanced Placement Scholarship Funding** — The Authority and the Missouri Commissioner of the Office of Administration agreed to extend, by three years to September 30, 2018, the date of the final distribution by the Authority for the remaining \$105,153 of the \$350,000 described in the LCDI Legislation. In connection with this extension, the Authority agreed to provide the State with \$30,000 of its operating funds to be used for need-based scholarship funding for Missouri students for the 2011-2012 academic year. This amount will partially offset dramatic reductions in scholarship funding by the State of Missouri due to budget shortfalls. This amount became available due to successful bond refinancings by the Authority. The first payment of \$9,000 was made to the State of Missouri on September 1, 2011, with subsequent payments of varying amounts planned on the first of the month for the next 7 months. During fiscal 2010, the Authority and the Missouri Commissioner of the Office of Administration entered into a similar agreement for a two year extension of the final LCDI distribution to September 30, 2015 in connection with the payment of \$30,000 for need-based scholarships for the 2010-2011 academic year.

In addition to the Access Missouri funding, the Authority's Board approved a payment of \$1,000 to the State to fund the new Advance Placement (AP) Incentive Grants program. As of July 1, 2011, no payments had been made to the State for this AP program. The Authority paid \$100 to the State for this program on September 15, 2011. The Authority may pay additional funds to the State this year if participation in the program warrants additional funding and/or if the funds are requested by the State.

The Authority will continue analyzing and determining on a quarterly basis what, if any, distribution the Authority should make to the LCDI Fund. The Authority is unsure whether it will be able to make any significant future distributions required by the LCDI Legislation on a timely basis or at all. Any such distributions by the Authority could substantially decrease the amount of its capital and, accordingly, erode its funds for new programs and contingencies related to current operations.

**2011-1 LIBOR Floating Rate Notes** — On July 19, 2011, the Authority issued \$576,800 in LIBOR floating rate notes to refinance the 2008 Trust Indenture, purchase FFELP loans from its lender partners and to purchase loans from the Authority's operating fund. The 2008 Trust Indenture was a \$262,500 variable rate demand note trust backed by a direct pay letter of credit from Bank of America. The LFRNs were issued in one series with a stated coupon of three month LIBOR plus 0.85% with an expected weighted average life of 5.74 years based on a two percent CPR and a final maturity of June 25, 2036. The Full Turbo trust had a starting parity of 103.89%. While the bonds carry a coupon of three month LIBOR plus 0.85%, the bonds were sold at a price of 99.1687%, resulting in an effective cost of three month LIBOR plus 1.00%.

**Bank of America Line of Credit** — On August 22, 2011, the Authority closed on a \$50,000 line of credit to purchase FFELP loans from lender partners and guarantors. The line of credit has a 364-day term with borrowing rate of LIBOR plus 0.55% and an unused commitment fee of 0.15%. The terms require a 106.5% parity ratio and permit a 0.75% servicing and administration draw. Eligible collateral limitations under the line of credit terms include: 50% for Consolidation loans originated before October 1, 2007, 25% for non-consolidation loans originated after October 1, 2007, and 15% for loans to students attending vocational, proprietary and/or two-year schools.

## 16. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

During fiscal year 2011, the Authority adopted the following Governmental Accounting Standards Board (GASB) Statements:

- Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which was effective for the Authority beginning in fiscal year 2011. This Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This pronouncement had no impact on current financial statements.
- Statement No. 59, *Financial Instruments Omnibus*, which is effective for the Authority beginning in fiscal year 2011. This Statement updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools. This pronouncement had no impact on current financial statements.

The GASB has issued the following statements which will be effective in future years as described below:

- Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple Employer Plans*, which is effective for the Authority beginning in fiscal year 2012. This Statement addresses issues related to the use of the alternative measurement methods and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans and clarifies when actuarially determined OPEB measures are reported by an agent multi-employer OPEB plan and its participating employees.
- Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which is effective for the Authority beginning in fiscal year 2013. This Statement addresses how to account for and report service concession arrangements (SCAs) by establishing recognition, measurement, and disclosure requirements for SCAs for both transferors and governmental operators.
- Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*, which is effective for the Authority beginning in fiscal year 2013. This Statement improves financial reporting for a governmental financial reporting entity by improving guidance for including, presenting, and disclosing information about component units and equity interest transactions of the entity.
- Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is effective for the Authority beginning in fiscal year 2013. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance included in the FASB and AICPA pronouncements issued on or before November 30, 1989. This Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments to that they derive from a single source.
- Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is effective for the Authority beginning in fiscal year 2013. This Statement provides financial reporting guidance for deferred outflows of resources and deferred



inflows of resources. This Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The requirements of this Statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government’s net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed.

- Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53*, which is effective for the Authority beginning in fiscal year 2012. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty’s credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or a swap counterparty’s credit support provider, is replaced.

The Authority has not yet determined the impact of implementing the above new pronouncements.

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# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## REQUIRED SUPPLEMENTARY INFORMATION SCHEDULE OF FUNDING PROGRESS AS OF AND FOR THE YEARS ENDED JUNE 30, 2011, 2010 AND 2009 (Dollars in thousands) (Unaudited)

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Actuarial Valuation Date	Actuarial Value of Assets Available for Benefits	Actuarial Accrued Liability (AAL)	Funded Ratio	Unfunded AAL (UAAL)	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
Pension Plan 7/1/2010	\$22,489	\$22,077	101.9 %	\$ (412)	\$10,118	N/A
Pension Plan 7/1/2009	18,562	20,675	89.8 %	2,113	10,708	19.7 %
Pension Plan 7/1/2008	18,939	19,224	98.5 %	285	10,195	2.8 %

## **INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Higher Education Loan Authority  
of the State of Missouri:

We have audited the financial statements of the Higher Education Loan Authority of the State of Missouri (the "Authority") as of and for the year ended June 30, 2011, and have issued our report thereon dated September 20, 2011, which report expresses an unqualified opinion and includes an emphasis of the matter paragraph relating to the change in accounting estimate discussed in Note 2. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The

results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, Board of Directors, others within the entity and the Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte + Loucheur*

September 20, 2011

## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON THE FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE PROGRAM-SPECIFIC AUDIT OPTION UNDER OMB CIRCULAR A-133**

To the Higher Education Loan Authority  
of the State of Missouri:

### **Compliance**

We have audited the Higher Education Loan Authority of the State of Missouri's (the "Authority's") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Authority's major federal programs for the year ended June 30, 2011. The Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

### **Internal Control Over Compliance**

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the

purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, Board of Directors, others within the entity and the Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

The logo for Deloitte & Touche, featuring the company name in a stylized, cursive script.

September 20, 2011

**HIGHER EDUCATION LOAN AUTHORITY  
OF THE STATE OF MISSOURI**

**SUPPLEMENTARY SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2011  
(Dollars in thousands)**

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<b>Federal Grantor</b>	<b>Federal CFDA Number</b>	<b>Federal Expenditures Received</b>
U.S. DEPARTMENT OF EDUCATION — Federal Family Education Loan Program (FFELP) — interest on student loans	84.032	\$ 26,073
U.S. DEPARTMENT OF EDUCATION — Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) — Income	84.032	<u>19,770</u>
TOTAL	84.032	<u>\$ 45,843</u>
		<b>Outstanding Balance at June 30, 2011</b>
TOTAL GUARANTEED LOANS OF THE AUTHORITY AT JUNE 30, 2011 — Guaranteed student loans:		
FFELP Program	84.032	<u>\$3,601,558</u>

See notes to supplementary schedule of expenditures of federal awards.

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## NOTES TO SUPPLEMENTARY SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2011

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### 1. DESCRIPTION OF PROGRAMS

**U.S. Department of Education** — FFELP enables the Higher Education Loan Authority of the State of Missouri (the “Authority”) to receive interest on subsidized guaranteed student loans during the period a student is attending school or during certain other allowable deferment periods.

The ECASLA programs enable the Authority to access affordable funding to purchase and originate loans and continue to carry out its purpose.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the federal awards program of the Authority conform to accounting principles generally accepted in the United States of America. The following is a summary of the Authority’s significant accounting policies for federal programs.

**Basis of Accounting** — The Authority maintains its schedule of expenditures of federal awards on an accrual basis of accounting. Under this method, revenues are recognized when earned and expenses are recognized when incurred.

**Federal Revenues** — The FFELP interest and the ECASLA income is used primarily for the purchase of student loans and the administration of the Student Loan Programs.

### 3. CONTINUING COMPLIANCE REQUIREMENTS

Guaranteed student loans impose no continuing compliance requirements other than to repay the loans and are not considered federal awards expended.

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# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2011

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### Part I — Summary of Auditors' Results

#### *Financial Statements:*

Type of auditors' report issued — unqualified

Internal control over financial reporting:

Material weakness(es) identified? \_\_\_\_\_ yes  no

Significant deficiencies identified not considered to be material weakness(es)? \_\_\_\_\_ yes  none reported

Noncompliance material to financial statements noted? \_\_\_\_\_ yes  no

#### *Federal Awards:*

Internal control over financial reporting:

Material weakness(es) identified? \_\_\_\_\_ yes  no

Significant deficiencies identified not considered to be material weakness(es)? \_\_\_\_\_ yes  none reported

Type of auditors' report issued on compliance for major programs — unqualified

Any audit findings disclosed that are required to be reported in accordance with Circular A-133 (section .510(a))? \_\_\_\_\_ yes  no

Identification of major programs:

**CFDA Number(s)**

**Name of Federal Program or Cluster**

84.032

Student Financial Aid Cluster

Dollar threshold used to distinguish between Type A and Type B programs — \$1,375,290

Auditee qualified as a low-risk auditee?  yes \_\_\_\_\_ no

### Part II — Financial Statement Finding Section

No matters are reportable.

### Part III — Federal Awards Findings and Questioned Cost Section

No matters are reportable.

# HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

## STATUS OF PRIOR AUDIT FINDINGS FOR THE YEAR ENDED JUNE 30, 2011

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### 2010-1

**Condition** — The statement of cash flows and related segment disclosures, were initially prepared by individuals at the Authority and significantly adjusted by the auditors. Auditor assistance in the preparation of the financial statements is consistent with historical practice.

**Current Year Status** — Corrective action was taken.