

**Higher Education Loan Authority
of the State of Missouri
(MOHELA)**

Independent Review and Funding Analysis
of the Cooperation Agreement

November 9, 2006

Liscarnan Solutions, LLC

Table of Contents

Executive Summary

- A. Background
- B. Cooperation Agreement Funding Requirements
- C. MOHELA Funding of Cooperation Agreement
- D. Consultant's Activities
- E. Analytical Methods
- F. Conclusions

I. Student Loan Industry Background

- A. A Brief History of the Industry
- B. Rapid Industry Change
- C. Comparing Student Loan Structures
- D. MOHELA Structure and Organization

II. Cooperation Agreement

- A. Background
- B. Cooperation Agreement Funding Requirements
- C. Other Important Features of the Cooperation Agreement

III. Cooperation Agreement Funding Analyses

- A. Funding Analysis Financial Model
- B. Loan Portfolios
- C. Structure of Liabilities
- D. Future Business Development

IV. Financial Model Cash Flows

- A. Planned Funding of Cooperation Agreement
- B. Resolution and Indenture Cash Flows

Conclusions

APPENDICES

- I. Governor's Lewis and Clark Discovery Initiative Proposal, January, 2006.
- II. MOHELA Funding Plan, dated January 31, 2006 and Revised March 10, 2006.
- III. The Higher Education Loan Authority of the State of Missouri, Audited Financial Statements, June 30, 2006.
- IV. MOHELA Financial Analysis for Funding the Lewis & Clark Discovery Initiative, September 8, 2006 (Management Presentation to the Members of MOHELA).
- V. Cooperation Agreement, approved by MOHELA Members September 27, 2006.
- VI. MOHELA Resolution, dated September 27, 2006, approving the Cooperation Agreement.
- VII. Valuing Tax-Exempt Bond Allocation, Columbia Capital Management, LLC, September 20, 2006
- VIII. Liscarnan Solutions, LLC
 - A. Firm Brochure
 - B. Project Team Biographies
 - C. Representative Engagements
- IX. Resolution and Indenture Cash Flows (CD enclosed)
 - A.1: 2005 Trust Assumptions
 - A.2: 2005 Trust Cash Flows
 - B.1: 6th Resolution Assumptions
 - B.2: 6th Resolution Cash Flows
 - C.1: 8th Resolution Assumptions
 - C.2: 8th Resolution Cash Flows
 - D.1: 9th Resolution Assumptions
 - D.2: 9th Resolution Cash Flows
 - E.1: 10th Resolution Assumptions
 - E.2: 10th Resolution Cash Flows
 - F.1: 11th Resolution Assumptions
 - F.2: 11th Resolution Cash Flows
 - G.1: 12th Resolution Assumptions
 - G.2: 12th Resolution Cash Flows

- H.1 BofA Warehousing Facility Assumptions
- H.2 BofA Warehousing Facility Cash Flows
- I.1 Taxably Financed New Loan Volume Assumptions
- I.2 Taxably Financed New Loan Volume Cash Flows
- J.1 Tax-Exempt Financed New Loan Volume Assumptions
- J.2 Tax-Exempt Financed New Loan Volume Cash Flows

Executive Summary

In August of 2006 management of the Higher Education Loan Authority of the State of Missouri (“MOHELA”) requested that Liscarnan Solutions, LLC (“Liscarnan” or “Consultant”) conduct an independent review of MOHELA’s ability to satisfy the funding commitments described in the Cooperation Agreement. Consultant’s report (“Funding Analysis”) is offered in response to management’s request.

Consultant was engaged with management during the summer of 2006 as the Cooperation Agreement developed. While research and financial analyses were conducted throughout August and September the analyses and conclusions contained in the Funding Analysis are based on the final form of the Cooperation Agreement, as approved on September 27, 2006 by the Members of MOHELA.

Please note that the Funding Analysis is the product of Liscarnan Solutions, LLC. While management’s assistance and cooperation was essential and forthcoming, Liscarnan Solutions, LLC bears sole responsibility for any errors or inaccuracies. Further, while containing discussions of future business, organization and structure changes, market commentary and planning for the future the Funding Analysis is not a business plan and should not be viewed as such.

A. Background

The process leading to the Cooperation Agreement commenced in January 2006 with the Governor’s Lewis & Clark Discovery Initiative (“LCDI”). LCDI proposed among other things to use MOHELA funds to assist public institutions of higher education in financing certain capital projects. MOHELA responded with a document titled “Funding Plan: Lewis and Clark Discovery Initiative”, dated January 31, 2006 and revised March 10, 2006 (“MOHELA Funding Plan”). The MOHELA Funding Plan proposed to deliver \$210,000,000 by September 30, 2006 and 16 future quarterly installments of \$15,000,000 each for a total of \$450,000,000.

Over the next several months, discussions involving MOHELA, the Governor’s office, legislative representatives and several state agencies, considered LCDI and the MOHELA Funding Plan. A new consensus developed and was memorialized in a document referred to as the Cooperation Agreement, which includes approximately \$350,000,000 for higher education capital improvement projects and for the Missouri Technology Corporation to aid in the commercialization of technology. The Cooperation Agreement is a multi-agency compact signed by four entities: MOHELA, the Department of Economic Development of the State of Missouri, the Missouri Development Finance Board (“MDFB”), and the Curators of the University of Missouri. In addition to funding certain other activities, the Agreement provides a framework for MOHELA funds to be periodically transferred to the MDFB, and for MOHELA to gain assured access to calculated amounts of private activity tax-exempt bond allocation.

The Members of MOHELA were briefed on the progress and content of the Cooperation Agreement as it developed.

Consultant's analysis of the Cooperation Agreement ("Funding Analysis"):

1. Describes the MOHELA funding requirements contained in the final form of the Cooperation Agreement,
2. Summarizes the results of certain financial analyses of MOHELA's current and projected assets and liabilities,
3. Describes the ability of MOHELA to fund commitments contained in the Cooperation Agreement, and
4. Discusses conclusions related to the expected impact of satisfying the funding of the Cooperation Agreement.

B. Cooperation Agreement Funding Requirements

The Cooperation Agreement calls for funds to be transferred from MOHELA to MDFB in accordance with the following schedule:

1. \$30,311,000 upon the effective date of the Agreement,
2. \$70,000,000 upon the later of the effective date of the Agreement or the effective date of proposed amendments to the Eleventh General Student Loan Bond Resolution permitting the withdrawal of such funds,
3. \$70,000,000 upon the later of the effective date of the Agreement or March 31, 2007,
4. \$40,000,000 upon the later of the effective date of the Agreement or September 30, 2007, and
5. \$140,000,000 payable in 24 quarterly installments of \$5,833,333 beginning not later than 270 days following execution of the Agreement.

C. MOHELA Funding of Cooperation Agreement

Consultant's financial analysis of MOHELA's current and projected assets and liabilities and their related cash flows provides for the release of funds in accordance with a similar but somewhat accelerated schedule:

1. \$30,311,000 funded \$8,811,000 from MOHELA's general fund and \$21,500,000 released from the 12th General Resolution coincident with a \$126 million taxable financing in June of 2006,
2. \$70,000,000 released from the Eleventh General Bond Resolution on November 1, 2006,
3. \$30,000,000 released from the 6th, 8th, 9th and 11th Resolutions on December 1, 2006,
4. \$80,000,000 derived from the sale of \$1.5 billion principal amount of consolidation loans and released from the Eleventh General Bond Resolution on April 1, 2007, and
5. \$140,000,000 in 24 installments commencing April 1, 2007.

Cash transfers for items 1, 2, and 3 amounting to \$130,311,000 will be satisfied with cash on MOHELA's balance sheet. Item 4, a cash transfer of \$80,000,000, will be covered largely with premium proceeds from the sale of \$1.5 billion of consolidation loans. Item 5, cash transfers amounting to \$140,000,000 over 24 quarters, relies on the continued success of MOHELA's businesses, particularly loan purchases from lender partners and its own in-house consolidation loan program both at current levels of profitability. The prospects for achieving Item 5 payments would be substantially enhanced if MOHELA were allowed to originate Stafford loans, thus, limiting the payment of substantial loan origination premiums on future acquisitions.

D. Conclusions

1. Consultant's financial analyses demonstrate that based on a series of expected case projected cash flows reflecting current market conditions, MOHELA will be capable of meeting the fund transfers called for in the Cooperation Agreement as described above.
2. Such fund transfers will not negatively affect the ability of MOHELA to continue to offer borrower benefit programs at their historical levels.
3. Loan sales are limited to non-Missouri loans financed with taxable bond proceeds. Such loans are less profitable to MOHELA and produce fewer

borrower benefits than loans of Missouri borrowers financed with tax-exempt bonds.

4. Direct origination of Stafford loans to Missouri students would enable improved borrower benefits and add \$2 million or more annually to the funds available for enhanced borrower benefits or other borrower and charitable purposes.
5. Funding requirements of the Cooperation Agreement will not negatively affect the credit ratings or interest rates on MOHELA's debt instruments. Although asset/liability coverage levels and future calls for quarterly payments reduce the financial strength of MOHELA's balance sheet, the funding requirements of the Agreement are not sufficient under current market conditions to trigger adverse responses in the financial markets. While any significant removal of assets from structured financings is a concern to the financial community, management recognizes that informing and updating rating agencies, credit providers and investors will mitigate such concerns.
6. Ten year tax-exempt bond cap allocation commitments in the Agreement offer MOHELA greater assurance of continued access to tax-exempt financing than has been true in the past. This opens opportunities for crafting programs for Missouri students that may not have been possible living on somewhat unpredictable year-to-year cap allocation.
7. MOHELA's ability to draw fees from its structured financings sufficient to cover administration and servicing expenses will not be damaged by the funding requirements of the Agreement.
8. During the process of funding the Agreement MOHELA's Asset/Debt Coverage Ratio may decline, possibly as low as 101.75; however, Consultant is of the opinion that a Ratio of 101.5 is more than sufficient for both credit rating and financial risk management purposes.

E. Consultant's Activities

In preparing this Funding Analysis Consultant conducted the following activities:

1. Reviewed MOHELA audited financial statements (Appendix III), dated June 30, 2006,
2. Received and analyzed all MOHELA student loan data files for the month ending July 31, 2006,
3. Reviewed changes to the Higher Education Act that may impact MOHELA's business particularly the elimination of the "single holder rule".

4. Reviewed Banc of America Securities, LLC indenture and resolution cash flows testing performance subject to certain versions of the Cooperation Agreement,
5. Reviewed Columbia Capital Management, LLC analysis, Valuing Tax-Exempt Bond Allocation, draft dated August 31, 2006 and final dated September 20, 2006 (Appendix VII),
6. Created cash flow projections for all MOHELA resolutions and trust indentures based on July 31, 2006 loan data (Appendix IX),
7. Tested projected cash flows for ability to satisfy Cooperation Agreement funding requirements,
8. Analyzed impact of Cooperation Agreement funding requirements on MOHELA credit ratings and cash flow adequacy,
9. Reviewed the signed version of the Cooperation Agreement which appears as Exhibit A to the MOHELA Resolution, dated September 27, 2006, and several prior progress drafts of the Agreement (Appendix V),
10. Reviewed final and draft forms of the MOHELA Resolution, dated September 27, 2006, approving the Cooperation Agreement (Appendix VI),
11. Reviewed management presentation for MOHELA Members for meeting on September 8th (Appendix IV).

F. Analytical Methods

Consultant's areas of expertise are finance and business development modeling focusing on the student loan industry, structured finance and asset securitization. In preparing the Funding Analysis we have made extensive use of cash flow modeling of MOHELA's existing portfolio of student loans. We have also used cash flow modeling techniques, common to the securitization industry, and certain reasonable assumptions regarding future business development to create expected case projections for MOHELA's future financial status.

We do not apply a risk related discount to cash flows for future loans. However, the user of the Funding Analysis should recognize that income from loans already booked has lower risk and less time related uncertainty than loans not yet booked.

I. Student Loan Industry Background

A basic understanding of industry changes that have occurred since 1981 when MOHELA was created may be helpful in placing the Cooperation Agreement and MOHELA's current status in context. The Members of MOHELA and its professional staff recognize that the industry has changed significantly in the recent past and that the Cooperation Agreement can play an important role in assisting MOHELA's future development. The very first whereas of the MOHELA Resolution, approving the Cooperation Agreement, includes the following statement

“...due to changes in the student loan industry, market factors and the economic and higher education needs of the State of Missouri, the Authority must consider the bold actions provided for herein in order to fulfill its purpose and powers and to attempt to secure and enhance its ability to assure the availability of student loans for Missouri families...”

The Cooperation Agreement offers three key items all of which are expected to produce material economic value to MOHELA and those that benefit from its programs. These items are: (1) assured access to tax-exempt financing, on which it earns its highest margins, (2) improved access to the student loan volume of Missouri state institutions of higher education and (3) improved statutory authority to originate student loans. A review of the industry will clarify why the terms of the Cooperation Agreement and future changes which may result from having initiated the process leading to the Agreement are important to MOHELA's future.

A. A Brief History of the Industry

The modern student loan industry began in the 1970s with what was known as the Guaranteed Student Loan Program (“GSLP”). GSLP was created to address the problems of the Federally Insured Student Loan program (“FISL”) and several other small specialty higher education loan programs created by the federal government and run largely by institutions of higher education. Among the problems were inadequate funding and school program managers that lacked knowledge of lending administration and practices. GSLP hoped to solve FISL's problems by introducing private lenders.

GSLP was slow to start even with the existence of Sallie Mae, a federally sponsored source of liquidity for lenders. In the early years of the program Sallie Mae provided lenders with liquidity by offering to buy their loans at a discount, i.e., a book loss. Although this offer was better than no liquidity it did little to encourage lender participation in GSLP. By the mid-1980s lender participation

started to rise. This was due, in large measure, to the liquidity terms offered by newly created non-profit corporations and state agencies, such as MOHELA. By the mid-1990's lenders started to seriously compete for loan volume. Lenders became more interested in retaining ownership of loans through direct ownership or securitization and less interested in selling their loans. Value was moving from the finance side of the business to loan originations.

By 1998 most non-profit and state agency student loan entities recognized that student loans were becoming more like financial commodities. Prices in the secondary market were being driven higher and risk adjusted loan yields were falling to competitive levels similar to other securitized assets such as home mortgages and consumer receivables. Most non-profits and state agencies recognized this trend and became loan originators. They have also altered their primary focus from providers of lender liquidity to providers of borrower benefits and other charitable activities and services to students and their families. MOHELA has gone part way down this road with the origination of PLUS and Consolidation loans. However, one notable absence is the lack of Stafford loan origination capacity. Ironically, MOHELA lacks what should be its core business – the ability to originate Stafford loans, the product most heavily utilized by students, on Missouri campuses.

By the year 2000, the value of loan origination activity was clearly growing. Loan prices were rising sharply. When student loan companies of similar size were sold those with origination franchises received materially higher prices than those without. It was becoming clear that entities controlling loan origination channels were in the strongest position deriving increasing value from their loans while secondary markets were receiving less value from their financing of student loans. Although MOHELA has not become a major direct originator of Stafford loans it has grown significantly by entering into loan acquisition partnerships with originators.

B. Rapid Industry Change

For much of the last thirty years the student loan industry could be characterized as “quiet”. Change occurred slowly, largely as a result of government regulations rather than market forces. Opportunities for rapid growth in profits and volume were limited. Lenders could make money consistently from year to year with a modest amount of working capital while incurring almost no risk.

Three years ago the world changed dramatically. In 2003, market forces swept through the industry producing devastating asset prepayments in most loan portfolios. Telemarketing companies, new to the industry, discovered strategies for hijacking lender's most valuable assets. Companies that a few short months ago were using their call centers to arrange loans for sub prime consumer loans, sell credit cards, offer long distance telephone service, solicit charitable

contributions, etc., were now producing billions of dollars of consolidation loans for borrowers at extraordinarily low interest rates. Under Title IV of the Higher Education Act borrowers were permitted to lock in a fixed interest rate on their consolidation loan at what amounted to short term rates, sometimes 3 percent or lower. In a low interest rate environment borrowers did not need to be convinced. Consolidation loans basically sold themselves.

Within 12 to 18 months, many student loan finance companies lost as much as 40 percent of their loan assets to these new competitors. The industry was stunned, and to a large extent no longer profitable. Traditional lenders made matters worse by refusing to become consolidators themselves. They were hoping that the consolidators would simply go away and the market would return to its previous state.

We urged our clients to become consolidators: first, to develop the systems and skills to protect their portfolios, and second, to participate in the most profitable student loan industry opportunity ever. We examined the economics of the consolidation opportunity for borrowers and its statutory origin. Although most knowledgeable analysts believed that this was a “statutory accident” both the consolidation opportunity and the consolidators were here to stay. Several consolidators now rank among the largest producers of student loans.

Unfortunately, at the time of the initial wave of consolidation, most non-profit corporations and state agencies decided to focus on regulatory and legislative fixes to the challenge presented by the new competitors. All of their efforts met with failure, and valuable time and assets were lost. All non-profits and state agencies of which we are aware have decided, however reluctantly, to offer some type of Consolidation product. As a servicer, MOHELA has direct contact with borrowers through its call center. This has contributed to reducing the amount of asset losses due to consolidation experienced by MOHELA.

In 2006, changes in the Higher Education Act reduced the attractiveness of consolidation for borrowers by changing the interest rate on Stafford and PLUS loans from a variable to a fixed interest rate. When borrowers refinance into a Consolidation loan, they will pay the same fixed interest rate as exists on the loans being refinanced. When a borrower consolidates in the future it will be to reduce the size of their monthly payments, the original purpose of consolidation under Title IV of the Higher Education Act, by extending the term of the debt, rather than achieving an interest rate reduction

Today, the student loan industry is highly competitive. Traditional commercial banking lenders are competing directly with consolidators that came into existence just a few years ago. Consolidators are now rapidly moving beyond loan consolidation into other aspects of student loans, such as campus-based Stafford lending, PLUS and GradPLUS loans, private loans, and direct marketing to students and their families. The industry is now attracting venture capital and

talented executives of the highest quality from many different industries. To those that choose to participate, student loans offer significant profit potential.

However, unlike the past, such profit potential is now accompanied by material business risks. Competing successfully in this market requires well-developed business plans that are diligently executed. Some state agencies and non-profit corporations believe that they are somehow insulated from the forces that govern other businesses in the student loan industry. Perhaps the comfort of low cost tax-exempt financing or operating in a tax-free environment leads them to believe that they can survive while underperforming in critical areas, such as marketing, finance, servicing, and controlling overhead.

We believe appropriate business models for state agencies and non-profit corporations in a competitive industry should look remarkably similar to their for-profit counterparts, only with public beneficiaries rather than stockholders.

C. Comparing Student Loan Company Structures

What is MOHELA? Is it a state agency, a non-profit entity, or a for-profit corporation? As a legal matter, according to the 1981 statute that created and defines MOHELA, it is an instrumentality of the State of Missouri governed by seven Members, five of which are appointed by the Governor with the consent of the Senate. The remaining two serve as a result of their positions, the Missouri Commissioner of Higher Education and a member of the Missouri Coordinating Board of Higher Education.

As a practical business matter, regardless of its legal structure, MOHELA must function much as its for-profit competitors. One of the important challenges facing state agency and non-profit student loan companies is how to go about crafting a successful business, inside legal structures that may have little resemblance to those of for-profit competitors.

In the past several years, non-profit student loan corporations have been successful in initiating or updating their business plans in response to changing market conditions. Once management and the board agree on a plan, sometimes no small task, management executes the plan. The plan is then periodically critiqued and updated.

State agency student loan companies have been less successful in adapting to change. We believe the reason may be that commitment to change at state agencies requires more policy participants with a greater diversity of interested parties. For example, at MOHELA important changes may require basic agreement among the Governor, the General Assembly, the Members of the Authority, management and various interest groups involved in the legislative and policy process. The Cooperation Agreement is an example of when this process

works well, but this does not approximate the freedom of action available to industry competitors.

Although state agencies face a more complex path to change, MOHELA is succeeding. In the state agency and non-profit environment, change does not always occur naturally. Market signals and organizational features that promote change in for-profit corporations may not exist in state agencies. Recognizing these structural weaknesses and creating conditions that compensate for them will enhance the potential for continuous success. Below we will discuss some of the actions that MOHELA management has taken to promote change and create an organizational environment to enhance success.

D. MOHELA: Structure and Organization

MOHELA management recognizes that the student loan industry is undergoing rapid change and becoming increasingly competitive. In response they have initiated several actions in the past two years to maintain and improve their market position. Management has developed a Strategy Map and Score Card to focus on the basic charitable and business elements of the organization, and to develop and quantify specific goals. Management has also started rethinking the company's organizational chart with the idea in mind of permitting individuals and groups to become more focused on specific areas of the business, such as marketing, servicing, finance, and administration. Most recently management has initiated a series of cost reduction efforts.

MOHELA's historical business structure is a governmental agency model, which is now evolving to a corporate model. The focus of a governmental agency is the efficient delivery of services supported by an annual budget, the basic planning document. Organization goals and objectives are created and performance evaluated, largely as internal matters with limited comparison to other industry participants. A corporate organization focuses on profitability and takes actions pursuant to a multi-year business plan. In addition to internally generated goals and objectives, corporations take much greater account of industry benchmarks and industry peers for comparison and evaluation purposes.

Comparing Governmental and Corporate Organizations

Governmental agencies at all levels (federal, state and local) routinely face the issue of how to provide services efficiently. While the private sector faces similar questions, it also possesses self-correcting mechanisms when companies make mistakes. Regularly available market signals, such as sales, earnings, market share and stock price enable private companies to adjust their activities to successfully pursue growth and profits.

Governmental agencies, which with rare exceptions are monopoly providers of services, generally do not go out of business if they fail to meet the needs of their constituents. MOHELA on the other hand is not a monopoly and could risk business failure if it does not satisfy its customers.

What Does Structure Mean for MOHELA?

While MOHELA has most of the trappings of a vertically integrated student loan business, its activities are not organized into a traditional business model. However, the organization chart developed by management is a step in the right direction. Many student loan industry participants have adopted corporate business models with many of the hallmarks of a for-profit business: three to five year business plans, profit centers, data and information flows that make profit center evaluation possible, delegation of authority, accountability for failure and rewards for success.

Modern vertically integrated student loan companies are generally divided into administration and three businesses: marketing, servicing and finance. Each business is responsible for contributing in a very specific way to the profitability of the company. Administration, i.e., executive leadership and overhead, has the job of melding these three businesses into a unified profitable entity that acts with common purpose pursuant to a written, quantified business plan.

During the past two years management has moved more towards a corporate model. It has developed a series of performance measurements for judging the activities of its departments. This is an important beginning which, in time, must develop into measurements that connect with MOHELA's economic success. Managers need to see themselves not as service providers based on a budget, rather as leaders running a profitable business. When managers ask questions, the Authority's information systems need to respond. Management is aware of the information and data limitations that they face, and efforts are being made to develop solutions, but effective solutions will require time and money.

We have worked on major restructurings of three student loan companies, and in each case, organizational structure played a major role in affecting the behavior of managers and employees. When structures are changed, managers and employees behaved differently. Provide managers and employees with the information systems to evaluate their behaviors and activities, and the results will be remarkable.

II. Cooperation Agreement

A. Background

The process leading to the Cooperation Agreement commenced in January, 2006 with the Governor's Lewis & Clark Discovery Initiative ("LCDI") (Appendix I). LCDI proposed among other things to use MOHELA funds to assist public institutions of higher education in financing certain capital projects. MOHELA responded with an offer of funding in a document titled "Funding Plan: Lewis and Clark Discovery Initiative", dated January 31, 2006 and revised March 10, 2006 ("MOHELA Funding Plan") (Appendix II).

The Funding Plan proposed to deliver \$210,000,000 by September 30, 2006 and 16 future quarterly installments of \$15,000,000 each for a total of \$450,000,000. Both the LCDI and the MOHELA Funding Plan were enthusiastically supported by most university and government representatives. Near the end of the legislative session in May of 2006, an amendment to MOHELA's statute was proposed to facilitate, among other things, the release of monies for LCDI purposes. However, no action was taken due to matters other than lack of legislative support.

Without diminishing the merit of the expenditures proposed in LCDI and paid for with monies from the MOHELA Funding Plan, these arrangements were somewhat one-sided. MOHELA provided monies to the State and received nothing in return. Over the next several months, discussions involving MOHELA and its management team, the Governor's office, legislative representatives and several state agencies considered alternatives. A new consensus developed around the concept of an "exchange of value". MOHELA would provide funding in return for certain rights and opportunities, which would enhance the development of its student loan business, particularly in Missouri. In addition, this new approach would eliminate certain legal concerns that were raised with the original LCDI proposal and the MOHELA Funding Plan.

The Members of MOHELA were briefed on the progress and content of the LCDI discussions as they developed during the summer of 2006. The primary briefing took place at a meeting of the Members on September 8, 2006 with a presentation by management (Appendix IV). Management's presentation included: a review of MOHELA's current financial status, a discussion of management's actions in preparation for funding the developing Cooperation Agreement, a review of the financial impact of certain funding requirements of the Cooperation Agreement and a discussion of other related financial information.

Additional discussions took place among the parties to the Cooperation Agreement and other State representatives during August and September to craft the final form of the Cooperation Agreement (Appendix V). The

Cooperation Agreement is a multi-agency compact signed by four public entities: the Higher Education Loan Authority of the State of Missouri (“MOHELA”), the Department of Economic Development of the State of Missouri (“DED”), the Missouri Development Finance Board (“MDFB”), and the Curators of the University of Missouri (“UM”). In addition to funding, in amounts totaling \$350,000,000, certain activities of the State, the Cooperation Agreement provides for MOHELA to gain assured access to calculated amounts of private activity tax-exempt bond allocation and, potentially, certain additional rights to originate Stafford loans in the future subject to legislative action.

On September 27, 2006 management recommended the Cooperation Agreement to the MOHELA Members, and they approved it by Resolution (Appendix VI).

B. Cooperation Agreement Funding Requirements

The Agreement calls for funds to be transferred from MOHELA to MDFB in accordance with the following schedule:

1. \$30,311,000 upon the effective date of the Agreement,
2. \$70,000,000 upon the later of the effective date of the Agreement or the effective date of proposed amendments to the Eleventh General Student Loan Bond Resolution permitting the withdrawal of such funds,
3. \$70,000,000 upon the later of the effective date of the Agreement or March 31, 2007,
4. \$40,000,000 upon the later of the effective date of the Agreement or September 30, 2007, and
5. \$140,000,000 payable in 24 quarterly installments of \$5,833,333 beginning not later than 270 days following execution of the Agreement.

C. Other Important Features of the Cooperation Agreement

1. **At Least \$1.1 Billion of Private Activity Bond Allocation.** The most significant element of value provided to MOHELA by the Cooperation Agreement is assured access to at least \$1.1 billion of Private Activity Bond Allocation over a ten year period. The State has made no similar commitment to any other user of Private Activity Bond Allocation. During the period of taxable/tax-exempt interest rate compression, 2001 to 2005, demand for tax-exempt private activity bonds declined significantly nationwide. Student loan entities, including MOHELA, eligible for tax-exempt financing, had no difficulty obtaining tax-exempt allocation from

- their states. As market interest rates have increased over the past year and the spread between taxable and tax-exempt interest rates have widened, the demand for Bond Allocation has increased. DED currently has more requests for allocations than can be satisfied. We expect that this situation will continue for the indefinite future unless interest rates again decline. Thus, this commitment offers MOHELA greater assurance of continued access to tax-exempt financing than has been true in the past.
2. **Student Loan Program Development.** The obvious value of tax-exempt financing is in the lower interest rate. Columbia Capital Management, LLC produced an illustration of the value that may result from reducing the cost of financing student loans with tax-exempt debt compared with taxable financing. This study appears as Appendix VII. However, there are other benefits resulting from an assured allocation of tax-exempt bonds beyond interest savings. A consistently available supply of tax-exempt bonds opens opportunities for crafting programs for Missouri students that may not have been possible with uncertain year-to-year tax-exempt cap allocations.
 3. **Financial Stability.** Loans financed with tax-exempt bonds are extremely low risk investments, which produce highly stable streams of income. This has the effect of reducing MOHELA's overall risk profile and enhancing long-term viability. Tax-exempt financings comprise about 20 percent of MOHELA's debt; however, they may produce as much as 75 percent of surpluses and net revenues.
 4. **Expanded Loan Origination Rights.** DED and MOHELA agree in the Cooperation Agreement to pursue legislative changes to permit MOHELA to originate Stafford loans. Stafford loans are the most common loan used by students. They form the core of the relationship between the borrower and the lender. The right to originate such loans offers MOHELA a marketing opportunity to secure the customer relationship. There is also an important financial benefit, lower cost of acquiring the loan asset. We expect that MOHELA will be able to originate such loans at about half the cost of acquiring them from lenders.
 5. **Expanded Markets.** Missouri's state educational institutions will benefit from the LCDI grants resulting from the Cooperation Agreement. These institutions may also agree to grow their student loan relationships with MOHELA. While this is no assurance of loan volume, the door has been opened by the Cooperation Agreement.
 6. **Expanding Beyond the Higher Education Community.** Resources will be made available to the Missouri Technology Corporation for the purpose of promoting economic development in the area of life sciences and

research. Economic development is an area that the student loan community has long ignored. A direct connection with economic development initiatives and an interest in a robust economy are consistent with the MOHELA's desires to enhance employment opportunities for its borrowers. Nothing minimizes delinquencies and defaults like having a job.

In summary, the Cooperation Agreement has developed into a classic economic trade. The State contributes something and achieves its objectives; MOHELA contributes something and receives an enhanced future consistent with its mission. The students of Missouri are the beneficiaries of the actions of both the State and MOHELA. This is government at its best.

III. Cooperation Agreement Funding Analysis

Section III describes the financial modeling used in measuring MOHELA's ability to release monies pursuant to the Cooperation Agreement. Performing this analysis is normally a fairly straightforward process of analyzing the ability of each of MOHELA's resolutions and indentures to meet certain financial viability standards subsequent to loan sales and extraction of monies required to fund the Cooperation Agreement. However, to remain financially healthy in the future, MOHELA also needs to maintain its base of loan assets. The amount of loans on MOHELA's balance sheet is important because earnings on such loans are the source of administrative and servicing expenses required to maintain healthy operations of adequate size. Consultant's analysis examines the effect of loan sales and extraction of monies, and their impact on the future viability of MOHELA's operations.

Our review of MOHELA's lender partner activities suggests that such purchases together with PLUS and Consolidation loans generated by MOHELA, and tax-exempt financing opportunities made available under the terms of the Cooperation Agreement, will produce loan volume and profits sufficient to maintain healthy operations for the foreseeable future.

A. Funding Analysis Financial Model

We have developed a financial model for the purpose of analyzing MOHELA's ability to comply with the Cooperation Agreement and to evaluate the impact of delivering such funds on MOHELA's financial viability. We converted MOHELA's balance sheet assets and liabilities for each affected resolution and indenture into future positive and negative cash flows. This is very similar to the cash flow analyses performed when preparing a new bond issue. Positive cash flows include such items as student loan interest and principal payments, default reimbursements and special allowance and interest subsidy payments. Negative cash flows include principal and interest payments on debt, other debt related expenses, administrative costs and servicing fees.

Cooperation Agreement payments, in effect, are both the removal of MOHELA balance sheet surpluses which have accumulated over the years as well as future earnings. Such payments are treated in the model as negative cash flows, similar to an expense, although they are unrelated to the production or maintenance of loans.

The financial model is built by starting with assets and liabilities from the MOHELA audited balance sheet of June 30, 2006. Only assets and liabilities producing positive and negative cash flows are included. Unamortized assets and liabilities with no future cash flow consequences are not included in the

financial model. We then add to the financial model successive layers of future loan volume, related debt, and the resulting revenues and expenses. When we run the model, loans are converted into positive cash flows as they repay, and servicing, administrative and other expenses are deducted resulting in net loan cash flows. Payment of principal and interest on debt and debt related expenses are then deducted from net loan cash flows. The resulting free cash flow is restricted as to use unless certain resolution or indenture covenants are satisfied, and thereafter, it is available for release.

B. Loan Portfolios

In the financial model loan portfolios come from four sources: Existing Loans as of July 31, 2006, and future loans for FY2007-2016 from Lender Partner Purchases, MOHELA Consolidation and PLUS originations, and MOHELA Missouri loan originations, tax-exempt financed.

1. Existing Loans

Existing Loans, amounting to approximately \$5.1 billion, are recorded in the servicer's electronic files as of July 31, 2006. We know a great deal about these loans and their behavior. Servicer files provide us with highly detailed loan specific data. Although the data is not static pool, many of these loans have been on the books of MOHELA for months or years offering a helpful track record. Reliable loan data enables the production of highly predictable cash flows, which present limited uncertainty or risk. The result is a high degree of confidence in business decisions based on such cash flows.

Table I

Higher Education Loan Authority of Missouri
GAAP Consolidating Balance Sheet
Fiscal Year Ended June 30, 2006
(dollars in thousands)

	<u>GAAP</u>
Assets	
Cash and investments held by trustee	\$318,614
Accrued interest on student loan receivables	132,452
Student loan receivables	5,238,174
Investments held by Trustee	12,885
Other assets	10,078
Capital assets	14,470
Total Assets	<u><u>\$5,726,673</u></u>
Liabilities & Net Assets	
Long-Term Liabilities	\$4,749,740
Current Liabilities	743,021
Total Liabilities	<u>5,492,761</u>
Net Assets	<u>233,912</u>
Total Liabilities & Net Assets	<u><u>\$5,726,673</u></u>

The loans shown in Table I constitute the core of MOHELA's highly reliable economic value and cash flows. Loan volume described in items 2 and 3 below result from future business activity and their value and the resulting cash flows will not be as reliable.

Before we move on to discussing loans resulting from future business activities we need to say a few words about the behavior of PLUS and Stafford loans in today's market and how it may affect MOHELA.

PLUS and Stafford loans have a highly uncertain average life due to their potential for consolidation. Loans purchased from MOHELA's lender partners are almost exclusively these loan types, and many will convert into consolidation loans. MOHELA does not presently have a tracking system for systematically measuring the impact of consolidation on its PLUS and Stafford loans. Thus, assumptions need to be made as to how consolidation will affect the economics of PLUS and Stafford loans. We propose the following disposition of PLUS and Stafford loans: 20 percent do not consolidate and will remain on the books of MOHELA, 16 percent consolidate with a competing lender after which MOHELA receives only the par amount of the loans, and 64 percent consolidate with MOHELA. We believe this disposition of PLUS and Stafford loans is consistent with the behavior of a lender exercising appropriate asset protection strategies, and would be achievable by MOHELA.

The above discussion of the impact of consolidation on the MOHELA's balance sheet applies to all Stafford and PLUS loans discussed in this Report.

2. FY2007-2011 Lender Partner Purchases and MOHELA Consolidation and PLUS Originations

According to management, acquisitions from lender partners are expected to amount to \$1.3 billion Stafford and PLUS loans annually for the foreseeable future. Such loans are acquired from lender partners at an average premium of approximately 4.10 percent of par. Of the \$1.3 billion, \$294 million remain on the books of MOHELA as PLUS and Stafford loans taxably financed, \$123 million are tax-exempt financed Missouri nexus loans that also remain on the books of MOHELA as PLUS or Stafford (many of which will consolidate), \$221 million will consolidate away to competing lenders, and \$662 million are consolidated by MOHELA and available for sale shortly after consolidation.

Lender Partner Purchases are of significant value to MOHELA and we urge that they continue. However, market forces are diminishing the financial attractiveness of such purchases as loan premiums paid by MOHELA rise. Based on market trends for this type of program, we are also concerned that some of MOHELA's Lender Partners may not remain viable participants consistent with the assumptions used in our cash flow modeling. For purposes of analyzing the Cooperation Agreement, this may not be a significant problem. As long as MOHELA continues to develop its business and eventually achieves the ability to originate Stafford loans, as suggested by the Cooperation Agreement, there are many aspects of the student loan industry where it could initiate or expand its activities. However, further discussion of such businesses and activities is beyond the scope of this analysis.

In addition to the \$1.3 billion of Lender Partner purchases, MOHELA management believes that it will produce new net consolidation loans of \$247 million annually in fiscal years 2007 through 2016, all of which will be sold. No purchase premium is paid for such loans. However, all normal costs of origination are provided for in the financial model.

3. Tax-Exempt Financing of Missouri Nexus Loans

We expect MOHELA will acquire, as part of its \$1.3 billion Lender Partner purchases, Missouri loans that will be tax-exempt financed. The amount of such loans is expected to grow from \$123 million in FY2007 to approximately \$188 million in FY2016. Tax-exempt financings for these acquisitions are expected to grow from \$130 million in FY2007 to \$192 million in FY2016. In addition, the terms of the Cooperation Agreement place a floor on the amount of tax-exempt

cap available to MOHELA. MOHELA may receive more tax-exempt discretionary cap than we have assumed in the future if it is available.

C. Structure of Liabilities

The most significant liabilities on MOHELA's balance sheet are various forms of debt. As shown in Table I the balance sheet shows approximately \$5.1 billion of debt as of June 30, 2006. Included in this debt are a variety of taxable and tax-exempt financing instruments, such as, variable rate demand bonds, auction rate securities, a small amount of fixed rate debt, and a line of credit facility. The financial model attempts to comply as closely as possible with the terms and conditions of MOHELA's current financings. Future financings are modeled using debt instruments similar to those already on MOHELA's balance sheet or those instruments currently in common use when financing student loans.

D. Future Business Development

The Cooperation Agreement discusses MOHELA becoming a Stafford loan originator while acknowledging that such a change would require statutory change. With the Cooperation Agreement opening the discussion consider the following items:

1. Directly serving the students and families of their respective states as a loan originator is the core business of most student loan state agencies and non-profit organizations. Direct origination of loans to Missouri students would enable improved borrower benefits and could add \$2 million or more of value annually to the funds available for education related and charitable purposes.
2. Margins on loans purchased from lender partners are declining. The value proposition of loans originated by MOHELA and financed with tax-exempt debt exceeds that of loans originated by lender partners and financed with the proceeds of taxable or tax-exempt debt. This gives MOHELA a fundamental financial advantage over for-profit competitors for a small portion of the Missouri student loan market.
3. Industry competition requires that MOHELA become a loan originator. As we discussed in Section I, successful student loan companies are adapting to a changing market by becoming more vertically integrated. There are three components to vertical integration: marketing, finance, and servicing. Marketing means loan originations. The value proposition for companies that control loan originations has been improving dramatically for several years. MOHELA has already established itself as a servicer and finance company. Its only missing component is that of Stafford loan originator.

Developing a core tax-exempt financed loan origination business in Missouri is not the only possible new business for MOHELA. Two additional possibilities include competing as a loan originator in the nationwide consolidation market, and developing a PLUS and Grad PLUS product in the national market. For an organization with commitment, the right structure, and available investment resources, both have reasonable opportunities for success.

IV. Financial Model Cash Flows

Consultant's analysis of the Cooperation Agreement ("Funding Analysis"):

1. Describes the MOHELA funding requirements contained in the final form of the Cooperation Agreement,
2. Summarizes the results of certain financial analyses of MOHELA's current and projected assets and liabilities,
3. Describes the ability of MOHELA to fund commitments contained in the Cooperation Agreement, and
4. Discusses conclusions related to the expected impact of satisfying the funding of the Cooperation Agreement.

A. Planned Funding of Cooperation Agreement

The Cooperation Agreement calls for funds to be transferred from MOHELA to MDFB in accordance with the following schedule:

1. \$30,311,000 upon the effective date of the Agreement,
2. \$70,000,000 upon the later of the effective date of the Agreement or the effective date of proposed amendments to the Eleventh General Student Loan Bond Resolution permitting the withdrawal of such funds,
3. \$70,000,000 upon the later of the effective date of the Agreement or March 31, 2007,
4. \$40,000,000 upon the later of the effective date of the Agreement or September 30, 2007, and
5. \$140,000,000 payable in 24 quarterly installments of \$5,833,333 beginning not later than 270 days following execution of the Agreement.

Consultant's financial analysis of MOHELA's current and projected assets and liabilities and their related cash flows provides for the release of funds in accordance with a similar schedule:

1. \$30,311,000 funded \$8,811,000 from MOHELA's general fund and \$21,500,000 released from the 12th General Resolution coincident with a \$126 million taxable financing in June of 2006,

2. \$70,000,000 released from the 11th General Bond Resolution on November 1, 2006,
3. \$30,000,000 released in the following amounts: \$5.9MM from the 6th Resolution, \$3.9MM from the 8th Resolution, \$3.6MM from the 9th Resolution, \$8MM from the 2005 Trust (this \$8MM could also have been withdrawn from the 11th Resolution), and \$8.6MM from the 11th Resolution on December 1, 2006,
4. \$80,000,000 derived from the sale of \$1.5 billion principal amount of consolidation loans and released from the 11th General Bond Resolution on April 1, 2007, and
5. \$140,000,000 in 24 installments commencing April 1, 2007. These monies are drawn from three sources: \$78.7 million from the 11th Resolution, \$15.8 million from future tax-exempt financings, and \$45.5 million from future taxable financings.

Cash transfers for items 1, 2, and 3 amounting to approximately \$130,000,000 will be satisfied with cash on MOHELA's balance sheet. Item 4, a cash transfer of \$80,000,000, will be covered largely with premium proceeds from the sale of \$1.5 billion of consolidation loans. Item 5, cash transfers amounting to \$140,000,000 over 24 quarters, relies for almost half of its funding commitment on the continued success of the MOHELA's businesses, particularly loan purchases from lender partners and its own in-house consolidation loan program, both at current levels of profitability. The prospects for achieving Item 5 payments would be substantially enhanced if MOHELA were allowed to originate Stafford loans, thus, avoiding the payment of substantial premiums to originating lender partners on a portion of future loan activity.

B. Resolution and Indenture Cash Flows

Appendix IX contains cash flow analyses for MOHELA's current and projected assets and liabilities resulting from the model described in Section III. For each financing structure, i.e., resolution, indenture or line of credit facility, there are two reports, (1) Assumptions and (2) Results. Assumptions include all of the information or inputs required to run the cash flow model. Results are the output of the model, which appear in the form of projected cash flows and a variety of performance metrics based on these cash flows.

1. Assumptions

Assumptions include much of the factual information that we know about the loans, investments and debt of a given financing structure. Loan information

comes from servicer data files and other MOHELA sources. Investment information comes from two sources: limitations placed on the use of monies by the terms of the indenture or resolution, and the specifics of actual investments from MOHELA management. Debt includes all of the terms of publicly offered debt, related credit enhancement devices, such as bond insurance, and warehousing facilities for the temporary financing of loans. Details of the debt structures are extracted from MOHELA's indentures and resolutions, offering statements, and other MOHELA sources.

In addition to factual information, Assumptions include inputs based on certain historical data and analytical judgments. Some of the historical data includes: interest rate trends and interest rate spread relationships, characteristics of future loans, loan payment patterns such as delinquency and default behavior, and prepayment and consolidation prospects for loans. For Results to be useful and reliable the application of inputs based on historical information involves a significant degree of judgment. This is not an attempt to forecast or predict future loan behavior, financial market conditions, or the exact performance of the MOHELA's resolutions and indentures over time. Applying analytical judgments to the crafting of assumptions is intended to produce cash flow results that reflect conservative expectations about the future viability of resolutions and indentures.

2. Results

The cash flow model used in this study translates the information contained in the Assumptions appendices (1) into cash flows that appear in the Results appendices (2). Of the many output reports that appear in the Results appendices the most important is titled "CASHFLOW". This report nets all positive and negative cash flows into a stream of future net cash flows free of all encumbrances. All other reports contained in Results appendices either: (1) isolate certain components of cash flow, such as debt payments, expenses, investment earnings or student loan revenues, or (2) compute certain financial metrics, such as present value, bond yield or loan yield.

3. Summarizing Cash Flows

Consultant has modeled each of MOHELA's current resolutions and indentures, including the Bank of America warehousing facility, largely using current balance sheet assets and liabilities. Assumptions and Results for each of these models appear as Appendices IX.A through IX.H. Cash flows for taxably financed future loan volume are in Appendix IX.I, and cash flows for tax-exempt financed future are in Appendix IX.J.

Conclusions

1. Consultant's financial analyses demonstrate that based on a series of expected case projected cash flows reflecting current market conditions MOHELA will be capable of meeting the fund transfers called for in the Cooperation Agreement and described above.
2. Such fund transfers will not negatively affect the ability of MOHELA to continue to offer historic borrower benefit programs at their current levels.
3. Loan sales are limited to non-Missouri loans financed with taxable bond proceeds. Such loans are less profitable to MOHELA and produce fewer borrower benefits than loans of Missouri borrowers financed with tax-exempt bonds.
4. Direct origination of Stafford loans to Missouri students would enable improved borrower benefits and add \$2 million or more annually to the funds available for enhanced borrower benefits or other borrower and charitable purposes.
5. Funding requirements of the Cooperation Agreement will not negatively affect the credit ratings or interest rates on MOHELA's debt instruments. Although asset/liability coverage levels and future calls for quarterly payments reduce the financial strength of MOHELA's balance sheet, the funding requirements of the Agreement are not sufficient under current market conditions to trigger adverse responses in the financial markets. While any significant removal of assets from structured financings is a concern to the financial community, management recognizes that informing and updating rating agencies, credit providers and investors will mitigate such concerns.
6. Ten year tax-exempt bond cap allocation commitments in the Agreement offer MOHELA greater assurance of continued access to tax-exempt financing than has been true in the past. This opens opportunities for crafting programs for Missouri students that may not have been possible living on somewhat unpredictable year-to-year cap allocation.
7. MOHELA's ability to draw fees from its structured financings sufficient to cover administration and servicing expenses will not be damaged by the funding requirements of the Agreement.
8. During the process of funding the Agreement MOHELA's Asset/Liability Coverage Ratio may decline, possibly as low as 101.75; however, Consultant is of the opinion that a Ratio of 101.5 is more than sufficient for both credit rating and financial risk management purposes.