MONTANA HIGHER EDUCATION

STUDENT ASSISTANCE CORPORATION

FINANCIAL REPORT

JUNE 30, 2010

CONTENTS

anderson ZURMUEHLEN

ANDERSON ZURMUEHLEN & CO., P.C. • CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS
MEMBER: AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS • MSI GLOBAL ALLIANCE INDEPENDENT MEMBER FIRM

DISCOVERY BLOCK • 828 GREAT NORTHERN BOULEVARD • P.O. BOX 1040 • HELENA, MONTANA 59624-1040
TEL: 406.442.1040 • FAX: 406.442.1100 • WEB: www.azworld.com

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Montana Higher Education
Student Assistance Corporation
Helena, Montana

We have audited the accompanying balance sheet of the Montana Higher Education Student Assistance Corporation (the Corporation) as of June 30, 2010, and the related statements of revenue, expense and changes in fund net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. Information for the year ended June 30, 2009 is presented for comparative purposes and was extracted from the financial statements presented by fund for that year, on which an unqualified opinion dated September 11, 2009, was expressed.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly the financial position of the Montana Higher Education Student Assistance Corporation as of June 30, 2010, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. 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 the information and express no opinion on it.

Anderson ZurMuehlen & Co., P.C.

Helena, Montana
September 28, 2010

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2010

This section of the Montana Higher Education Student Assistance Corporation's (MHESAC or the Corporation) annual financial report presents our discussion and analysis of the Corporation's financial performance during the years ended June 30, 2010 and 2009. Please read the following in conjunction with the Corporation's financial statements and accompanying notes.

MHESAC is a Montana not-for-profit corporation that was incorporated in 1980. MHESAC is designated as the sole and exclusive not-for-profit corporation in the State to provide a student loan secondary market to support the Federal Family Education Loan Program (FFELP). MHESAC is supported entirely through earnings on the student loans that it owns. MHESAC's activities include FFELP student loan acquisition, origination and servicing; bond issuance to raise capital for its FFELP student loan activities and rebates and rate reductions to student loan borrowers as part of its commitment to helping Montana students lower the cost of financing their education. As a not-for-profit entity that issues tax-exempt debt, MHESAC is classified as a "governmental nonprofit" entity for accounting purposes.

Financial Reporting Methodology Overview

This annual report consists of MHESAC's basic financial statements and Management's Discussion and Analysis. As discussed in Note 1, Summary of Significant Accounting Policies, GASB 34 requires a discussion of results of operations and financial position and a presentation of financial statements in a manner similar to private business. MHESAC follows proprietary fund reporting. Accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

The basic financial statements include the balance sheet, which reports the assets owned by MHESAC, its liabilities or what it owes to others and total fund net assets as of its fiscal year end; the statement of revenues, expenses and changes in fund net assets, which reports the operating net income plus non-operating revenue and expenses to arrive at a change in fund net assets; and a statement of cash flows, which describes the sources and uses of MHESAC's cash during the year.

It is important to note that MHESAC has both restricted and unrestricted assets and fund net assets. Restricted refers to the assets and net assets whose use is restricted by the bond indentures. The restricted assets must be used in accordance with stipulations in the governing bond indenture. They cannot be used for any other purpose. Unrestricted assets and fund net assets are items that are not restricted in their use, what we call the general fund. These unrestricted assets were either acquired outside of the bond indentures through general fund operations or from previously restricted funds that have now been released to the general fund via indenture satisfaction such as full redemption of outstanding bond issues.

Financial Position Summary

Following is an analysis of MHESAC's financial position at June 30, 2010 with comparative information at June 30, 2009 (000s omitted):

Assets:	**6/30/2010**	6/30/2009
Cash and cash equivalents	**$ 51,431**	$ 139,442
Investments	**27,251**	88,386
Educational loans receivable, net	**1,507,884**	1,575,654
Other assets	**59,878**	66,486
Total assets	**$ 1,646,444**	$ 1,869,968
Liabilities and Net Assets:		
Current liabilities	**$ 76,546**	$ 63,856
Long-term debt and obligations	**1,537,209**	1,776,891
Other liabilities		
Fair value of swap agreements	-	450
Arbitrage rebate and excess interest liability	**6,726**	7,043
Total other liabilities	**6,726**	7,493
Total liabilities	**1,620,481**	1,848,240
Net assets		
Restricted net assets	**4,024**	(2,009)
Unrestricted net assets	**21,939**	23,737
Total net assets	**25,963**	21,728
Total liabilities and net assets	**$ 1,646,444**	$ 1,869,968

At June 30, 2010 MHESAC had cash and cash equivalents of over $51 million of which approximately $3.2 million is unrestricted and $48.2 million is restricted under the bond and note indentures. The cash equivalents in the restricted fund are made of cash temporarily held by the trustee in short-term investments until the funds can be invested in the guaranteed investment contracts and the funds from the 2007 bond financing that are being held in liquid investments. The indenture defines how cash is to be handled within the restricted funds and there are guaranteed investment contracts associated with most bond issues that invest all funds until needed for debt payments, loan acquisitions or servicing and management costs.

Following is a breakdown of the different loan types held by MHESAC at June 30, 2010 (gross loan amounts):

	Montana	Non-Montana	Total
Stafford	$ 427,459,152	$ 13,712,162	$ 441,171,314
PLUS	49,766,853	2,218,044	51,984,897
Consolidation	596,196,910	419,006,449	1,015,203,359
Other	256,921	-	256,921
Total	$ 1,073,679,836	$ 434,936,655	$1,508,616,491

During the fiscal year MHESAC increased the reserve for bad debts. The reserve, which is netted against the student loans receivable for financial statement presentation increased from $604,279 to $733,060 to reflect the greater exposure to the risk of default on the loans based on the slight increase in loan claims made.

Results of Operations Summary

MHESAC is reporting operating income of $5,571,000 for the fiscal year ended June 30, 2010. Note the following analysis of operating revenue and expense sources followed by non-operating revenues (expenses) (000s omitted):

Operating Revenue Sources

	FY Ended 06/30/10	FY Ended 06/30/09
Interest on investments	**$ 968**	$ 6,163
Interest on student loans	**49,620**	67,401
Gain on bond repurchase	**4,656**	109
Gain on sale of loans	**1,949**	-
Other income	**179**	191
Total operating revenue	**57,372**	73,864

Results of Operations Summary (Continued)

Operating Expense Sources

	FY Ended 06/30/10	FY Ended 06/30/09
Bond and note interest	**16,872**	49,186
Bond fees	**1,377**	2,511
Loan fees	**16,241**	18,274
Management & servicing cost	**15,273**	15,914
Other costs	**2,038**	906
Total operating expenses	**51.801**	86,791
Operating profit (loss)	**5,571**	(12,927)
Non-Operating Revenues (Expenses)		
Arbitrage rebate	**$ (2,396)**	$ (430)
Excess interest rebate	**610**	3,358
Change in fair value of interest rate swaps	**450**	1,536
Total non-operating revenues (expenses)	**(1,336)**	4,464
Increase (decrease) in net assets	**4,235**	(8,463)
Fund net assets, beginning of year	**21,728**	30,191
Fund net assets, end of year	**$ 25,963**	$ 21,728

Arbitrage and excess interest rebate revenue and expenses in the amount of $2,396,000 (expense) and $610,000 (income), respectively, for fiscal year 2010 have been classified as non-operating activity. This is consistent with the treatment for the same income and expense in prior years. Management has concluded that this activity is interrelated and directly affected by other activities that are reported as non-operating and should be reported similarly as the fluctuations caused by changes in other non-operating activity may be misleading as a component of operating income.

The following is an overview of changes in financial data from FY 09 to FY 10:

- Cash and equivalents decreased by $88,011,000
- Net student loan receivables decreased by $67,770,000
- Investments decreased by $61,135,000
- Debt consisting of bonds outstanding decreased by $240,342,000
- The liability for the fair market value of the swaps decreased by $450,000 when the swaps matured during the fiscal year

Results of Operations Summary (Continued)

- MHESAC's net assets increased by $4,235,000
- Total operating revenues decreased by $16,492,000
- Total operating expenses decreased by $34,988,000

What the financial statements tell us is that MHESAC's financial health was strengthened during fiscal year 2010 in terms of its operating activities. Although operating revenues decreased due primarily to the continued declining interest rate environment, operating expenses decreased by an even greater amount.

Revenues

Operating revenues from the student loans are variable in nature and are based on the commercial paper or Treasury bill rate. As the commercial paper rate continued to decrease over the course of the fiscal year, so too did the revenue generated on those assets.

On May 7, 2008, the Ensuring Continued Access to Student Loans Act (ECASLA) was signed into law. One of the programs created by ECASLA was a program whereby lenders could sell student loans to the Department of Education under a program called the PUT Program. During the most recent fiscal year, MHESAC participated in the PUT Program and sold loans that had been originated or acquired during the 09-10 academic year. On June 25, 2010, MHESAC completed its first PUT sale in the principal amount of $99 million. As a result of this sale, MHESAC was paid for the principal on the loans, any accrued borrower interest, reimbursement of the 1% lender fee assessed by the DOE when the loan was originated and a $75 per loan reimbursement for origination costs.

Bond Activity

During the year, all but one series of MHESAC's auction bonds continued to be illiquid in their periodic auction. What this means is that bondholders wishing to sell their position in MHESAC bonds could not sell because there were no buyers in the market.

All of the twenty-two series of tax-exempt auction bonds continued to be illiquid on their reset dates during the fiscal year. MHESAC experienced the first tax-exempt liquidity issue on February 11, 2008 and every auction thereafter was illiquid. When the tax-exempt auctions are illiquid, the bond resets at a prescribed rate, called Maximum Bond Rate that during the reporting period was based on 175% of either the SIFMA index or the after-tax equivalent of the AA commercial paper rate.

The first taxable auction bonds were illiquid on February 13, 2008 and all but one series have been illiquid since then. The Max Rate on the senior taxable bonds is 30-day LIBOR plus 1.5% and for the subordinate taxable bonds is 30-day LIBOR plus 2.5%. These are the rates that the bonds are accruing based on the Max Rate formula.

However, there is another rate called the Net Loan Rate that defines how interest on taxable auction bonds will actually be paid out. Those rates were between 0.01% and 1.39% at June 30, 2010. The difference between the Max Rate and the Net Loan Rate is accrued for carry-forward and eventual payout to the bondholder.

The Variable Rate Demand Obligations (VRDOs) that were issued in December 2007 were backstopped by a liquidity facility in the form of a standby bond purchase agreement. The original issuance amount was $175,000,000. Essentially, if a bondholder puts a VRDO for sale on a reset date, and there are no other interested buyers at that time, the liquidity provider, Depfa Bank, will guarantee liquidity to the bondholder. On September 30, 2008, Moody's downgraded Depfa Bank. The result was that all bondholders put their bonds for sale requiring Depfa to buy them. The bonds then became bank bonds and revert to a set of rules prescribed in the bond indenture. The rate on the bank bonds was based on LIBOR plus a constant margin of 0.75% through December 31, 2010 and then changed to prime rate plus 2.25% for the remainder of the life of the bond. The documents also call for a mandatory 30 year amortization on the bonds with payments being made every June 1 and December 1. Due to the high interest rate on these bonds, MHESAC worked hard during the year to eliminate the impact of the onerous rate by redeeming and retiring these bonds during the year. In addition to the mandatory amortization on the bonds on December 1 and June 1, MHESAC also retired an additional $154,000,000 of the 2007 Series bonds via special redemption. At the end of the fiscal year, only $9,320,000 of the bonds remained outstanding. The balance of the VRDO bank bonds was ultimately redeemed after the close of the fiscal year on August 13, 2010.

As noted above, the liability for the fair value of the swaps decreased in FY 2010 because the interest rate swaps matured in August 2009. Therefore, MHESAC no longer has any obligation to the counterparty under these agreements. MHESAC originally entered into interest rate swap agreements to hedge the risks relating to the changes in interest rates on auction rate bonds that are secured by fixed rate loans thereby matching our assets and related liabilities and locking in a spread on the underlying student loans.

Accounting principles require us to value the swaps at fair value at the balance sheet date. This value is called the “mark to market” value and it fluctuates each month as assumptions about future interest rates change. It is important to point out that this “mark to market” value is what MHESAC would receive or pay to terminate the swap agreements at the reporting date. At June 30, 2009, this liability was $450,512 and at June 30, 2010 the liability was $0 due to the maturation of the swap agreements.

Long-term Debt Activity

MHESAC issues both tax-exempt and taxable bonds to raise capital for its student loan origination and acquisition activities as more fully described in the accompanying notes to the financial statements. During the year ended June 30, 2010, all bonds issued and outstanding are rated by at least two of the national rating agencies. The senior bonds all carry an “AAA” rating and all subordinate bonds carry an “A” rating. During the year there were no changes in the ratings of MHESAC’s bonds and they were affirmed by Fitch Ratings, one of the three rating agencies. Subsequent to year-end, MHESAC was notified that Fitch lowered its rating of all subordinate bonds from A/LS3 to B/LS3, with a stable outlook. At this time, Fitch again affirmed the AAA rating on all Senior bonds. The impact of the ratings action is that the mechanism for calculating the periodic interest rate on the subordinate bonds will change and will be higher.

In the fiscal year that ended June 30, 2010, MHESAC redeemed some outstanding bonds through both scheduled redemptions and special redemptions. MHESAC also retired some bonds after buying them back on the open market. Scheduled redemptions totaled $34,876,000. Special redemptions of the bank bonds totaled $154,000,000. Scheduled redemptions of the bank bonds (VRDOs) were $5,840,000. Bonds totaling $33,450,000 were purchased on the market and retired. In total, bonds redeemed and retired were $228,166,000.

An analysis of the change to bonds outstanding follows:

	Current Portion	Long-term Portion
Bonds outstanding at 7/01/09	$ 55,813,000	$ 1,773,186,846
Scheduled redemption and targeted payments of 1995,1998, 1999, 2000, 2005 and 2006 Series bonds	(34,876,000)	-
Special redemption of 2007 Series bonds	-	(154,000,000)
Redemption of 2007 VRDOs from amortization provision for bank bonds.	(5,840,000)	-
Buyback of 1995, 2000, 2001, 2003 and 2006 Series bonds	-	(33,450,000)
Accretion of zero coupon bonds	-	57,154
Reclassification to current	52,950,000	(52,950,000)
Bonds outstanding at 6/30/10	$ 68,047,000	$ 1,532,844,000

Following is a table showing the face amount of total bonds outstanding by bond type and the amounts that were auction rate bonds:

	6/30/2010 Par Value	% of Total	6/30/2009 Par Value	% of Total
Auction Rate Bonds:				
Tax-Exempt	$1,117,900,000	69.8%	$1,151,200,000	62.9%
Taxable	96,350,000	6.0%	96,500,000	5.3%
Fixed Rate Bonds				
Tax-Exempt	43,185,000	2.7%	47,545,000	2.7%
Floating Rate Notes				
Taxable	334,136,000	20.9%	364,652,000	19.9%
Variable Rate Demand Obligations				
Tax-Exempt	9,320,000	0.6%	169,160,000	9.2%

Significant Events

The Student Aid and Fiscal Responsibility Act (SAFRA), which was included in the health care reconciliation bill that was signed into law on March 30, 2010, effectively eliminated new loan activity for the Federal Family Education Loan Program (FFELP) in which MHESAC participates. Effective July 1, 2010, all new federal student loans will be provided by the Direct Loan program rather than by the private sector participants. Therefore, MHESAC will no longer be originating or acquiring new loans beyond that date. MHESAC will continue to manage its existing FFELP student loan portfolio during the remaining life of those loans, which can extend up to thirty years.

FINANCIAL STATEMENTS

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
BALANCE SHEET
June 30, 2010 and Comparative Totals for 2009
(expressed in thousands)

ASSETS	2010	2009
CURRENT ASSETS		
Cash and cash equivalents	$ 3,255	$ 2,203
Investments	873	884
Accrued interest receivable	108	200
Real estate loan receivable, related party	177	163
Prepaid costs, net of accumulated amortization	179	468
Other assets	27	8
Total Current Assets	4,619	3,926
RESTRICTED ASSETS		
Cash and cash equivalents	48,176	137,239
Investments	26,378	87,502
Educational loans receivable, net	1,502,559	1,569,768
Accrued interest receivable	22,647	22,761
Prepaid costs, net of accumulated amortization	23,468	28,051
Other assets	1,553	922
Total Restricted Assets	1,624,781	1,846,243
OTHER ASSETS		
Educational loans receivable, net	5,325	5,886
Deferred bond issuance costs, net of accumulated amortization of $7,635,554 in 2010 and $5,617,775 in 2009	9,834	11,852
Real estate loan receivable, related party	1,884	2,061
Total Other Assets	17,043	19,799
TOTAL ASSETS	$ 1,646,444	$ 1,869,968

The Notes to Financial Statements are an integral part of this statement.

LIABILITIES AND NET FUND ASSETS	2010	2009
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 7,669	$ 6,634
Accrued interest payable	830	1,166
Other liabilities	-	243
Educational loan revenue bonds payable - current portion	68,047	55,813
Total Current Liabilities	76,546	63,856
LONG-TERM DEBT		
Accrued interest payable	4,365	3,704
Educational loan revenue bonds payable	1,532,844	1,773,187
Total Long-Term Debt	1,537,209	1,776,891
OTHER LIABILITIES		
Fair value of swap agreements	-	450
Contingent arbitrage rebate liability	5,937	5,200
Contingent excess interest liability	789	1,843
Total Other Liabilities	6,726	7,493
TOTAL LIABILITIES	1,620,481	1,848,240
FUND NET ASSETS		
Restricted net assets (deficit)	4,024	(2,009)
Unrestricted net assets	21,939	23,737
Total Fund Net Assets	25,963	21,728
TOTAL LIABILITIES AND FUND NET ASSETS	$ 1,646,444	$ 1,869,968

(THIS PAGE INTENTIONALLY LEFT BLANK)

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF REVENUE, EXPENSE AND CHANGES IN FUND NET ASSETS
Year Ended June 30, 2010 and Comparative Totals for 2009
(expressed in thousands)

	2010	2009
OPERATING REVENUE		
Interest on investments and cash equivalents	$ 968	$ 6,163
Interest on educational loans (net of expense for uncollectible accounts of $131,391 in 2010 and $16,210 in 2009)	49,620	67,401
Income from sale of loans	1,949	-
Gain on bond repurchase	4,656	109
Interest on real estate note	179	191
Total Operating Revenue	57,372	73,864
OPERATING EXPENSE		
Financing expenses:		
Bond and note interest	16,872	49,186
Amortization of bond issuance costs	2,017	884
Auction agent/broker fees	713	1,923
Bond fees	664	588
Loan fees	16,241	18,274
Contracted management fees	3,159	2,925
Contracted loan servicing fees	12,114	12,989
Administrative expenses	21	22
Total Operating Expense	51,801	86,791
Operating income (loss)	5,571	(12,927)
NONOPERATING REVENUES (EXPENSES)		
Arbitrage rebate	(2,396)	(430)
Excess interest rebate	610	3,358
Change in fair value of interest rate swaps	450	1,536
Nonoperating Revenues (Expenses)	(1,336)	4,464
INCREASE (DECREASE) IN NET ASSETS	4,235	(8,463)
FUND NET ASSETS, BEGINNING OF YEAR	21,728	30,191
FUND NET ASSETS, END OF YEAR	$ 25,963	$ 21,728

The Notes to Financial Statements are an integral part of this statement.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF CASH FLOWS
Year Ended June 30, 2010 and Comparative Totals for 2009
(expressed in thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Interest received on student loans	$ 31,366	$ 53,924
Interest received on investments	1,148	6,916
Interest received on real estate and operating notes	179	191
Income from sale of loans	1,949	-
Bond and note interest paid	(16,348)	(46,632)
Cash paid to interest rate swap counterparties	(696)	(2,470)
Auction agent/broker fees paid	(781)	(1,954)
Bond fees paid	(177)	(409)
Loan fees paid	(11,728)	(15,399)
Contracted management & servicing fees paid	(15,620)	(15,453)
Administrative expenses paid	(20)	(82)
Net cash used in operating activities	(10,728)	(21,368)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of educational loans	(38,902)	(181,845)
Repayments of educational loans	125,493	102,126
Repayments of loans on sale of assets	163	117
Purchase of investments	(239,261)	(390,003)
Proceeds from sale of investments	300,394	499,256
Net cash provided by investing activities	147,887	29,651
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Arbitrage Rebate paid	(1,660)	(1,033)
Repayment of bonds	(223,510)	(43,473)
Payment of bond issuance costs	-	(1)
Net cash used in financing activities	(225,170)	(44,507)
Net decrease in cash and equivalents	(88,011)	(36,224)
Cash and cash equivalents, beginning of year	139,442	175,666
Cash and cash equivalents, end of year	$ 51,431	$ 139,442

The Notes to Financial Statements are an integral part of this statement.

	2010	2009
A reconciliation of cash and cash equivalents as shown on the balance sheet for MHESAC follows:		
Cash	**$ 3,255**	$ 2,203
Restricted assets	**48,176**	137,239
Cash and cash equivalents	**$ 51,431**	$ 139,442

A reconciliation of operating income to cash provided by operating activities follows:

	2010	2009
Cash Flows From Operating Activities:		
Operating income (loss)	**$ 5,571**	$ (12,927)
Adjustments to reconcile operating income (loss) to net cash provided by operations:		
Amortization of bond issuance costs	**2,017**	884
Uncollectible accounts expense	**(131)**	(16)
Gain on reacquisition of bonds	**(4,656)**	(109)
Zero coupon bond accretion	**57**	188
Change in assets and liabilities:		
Interest receivable	**(20,001)**	(16,671)
Other assets	**5,054**	3,308
Accounts payable and accrued expenses	**1,037**	3,915
Accrued interest payable	**324**	60
Net cash used in operating activities	**$ (10,728)**	$ (21,368)

	2010	2009
Supplemental Information:		
Non-cash Investing and Financing Activity:		
Accrued interest capitalized	**$ 20,345**	$ 17,741
Value of swap	**450**	1,536
Student loan borrower rebates granted	**445**	481
	$ 21,240	$ 19,758

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization:
Montana Higher Education Student Assistance Corporation (herein referred to as MHESAC or the Corporation) is a Montana not-for-profit corporation incorporated in 1980. The governor of the State of Montana has designated MHESAC as the sole and exclusive not-for-profit corporation in the State to provide a statewide student loan acquisition program in connection with the guaranteed student loan program provided by the Higher Education Act and Section 103(e) of the Internal Revenue Code. The Corporation is organized exclusively for the purposes of lending and providing funds for the acquisition of student loans and performing procedures for servicing loans. On February 1, 2000, the Corporation sold all its operating assets and transferred its employees to Student Assistance Foundation of Montana (SAF), a Montana not-for-profit corporation. The Corporation and SAF entered into management and servicing agreements, pursuant to which SAF agrees (1) to provide the Corporation with all necessary management and administrative services, including those required to operate the Corporation's student loan acquisition program and to perform the Corporation's responsibilities under the Indenture, and (2) to service all student loans owned by MHESAC.

Income Tax Status:
MHESAC is a not-for-profit corporation exempt from taxation under Internal Revenue Code Section 501(c)(3). Accordingly, no provision for income taxes is necessary in the accompanying financial statements.

Generally Accepted Accounting Principles generally accepted in the United States of America (GAAP), as promulgated by the Financial Accounting Standards Board, establish the accounting for uncertainties in income taxes recognized in an entity's financial statements and prescribe a threshold of more-likely-than-not for recognition and de-recognition of tax positions taken or expected to be taken in a tax return. The determination of tax exempt status is considered to be a tax position taken with respect to the provisions of GAAP.

The Corporation's policy is to evaluate the likelihood that its uncertain tax positions will prevail upon examination based on the extent to which those positions have substantial support within the Internal Revenue Code and Regulations, Revenue Rulings, court decisions and other evidence. It is the opinion of management that the Corporation has no uncertain tax positions that would be subject to recognition under GAAP. Generally, the Corporation's returns are no longer subject to review for years prior to the tax year ended June 30, 2007. It is the Corporation's policy to report penalties and interest related to tax filings in the year in which they were incurred.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Basis of Presentation:
As a non-profit entity that issues tax-exempt debt, MHESAC is classified as a "governmental nonprofit" entity. The Corporation implemented the Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" for financial reporting effective for fiscal years beginning July 1, 2002. MHESAC follows proprietary fund reporting. In accordance with GAAP, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Private-sector standards are generally followed provided they do not conflict with or contradict guidance of the GASB. The Balance Sheet is presented in a classified format and separates unrestricted and restricted assets. The Statement of Revenues, Expenses and Changes in Fund Net Assets is formatted to report operating and non-operating revenues and expenses. The Statement of Cash Flows is presented using the direct method. MHESAC considers the following revenue components to be operating income: interest income derived from investments, cash equivalents and educational loans, gains on bond repurchases, gains on loan sales, interest on real estate notes and operating notes as well as other miscellaneous income.

Management's Discussion and Analysis ("MD&A") is considered to be required supplemental information and precedes the financial statements.

Accounting Estimates:
The preparation of financial statements in conformity with GAAP 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 date of the financial statements, and the reported amounts of revenues and expenses during the reported period. The fair value of the interest rate swap agreements reported at June 30, 2009 were based on estimates about future LIBOR, SIFMA and bond auction rates, the indices to which the variable rates are tied. The interest rate swap agreements matured during the year ended June 30, 2010.

Other significant estimates include contingent liabilities for excess interest on student loans and arbitrage rebate, both more fully described below. Both may vary depending on adopted methodology and are subject to regulatory change. It is reasonably possible these estimates could change in the near term.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents:
Cash and cash equivalents includes all checking accounts, money market accounts and highly liquid securities with a maturity of three months or less at the date of purchase. MHESAC maintains deposits at one financial institution. At June 30, 2010, the book balance amount of those deposits was $3,156,516 with a bank balance of $3,157,102 of which $2,907,102 exceeded federal depository insurance. The cash equivalents in the restricted fund are comprised of cash temporarily held by the trustee in short-term investments until the funds can be invested in the guaranteed investment contracts and the funds from the 2007 bond financing that are being held in liquid investments.

Investments:
Investment instruments held in the temporarily restricted funds are restricted by the bond indentures. The Corporation invests in highly liquid investments such as U. S. government obligations and investment contracts. Credit risk on investment agreements is based on the agreement providers' ability to repay funds loaned by MHESAC for investment under the agreements. These agreements contain collateral provisions to mitigate such risk. Investment instruments are reported at fair value. Fair value exceeds cost of investments by $18,074 and $29,030 at June 30, 2010 and June 30, 2009, respectively. The resulting unrealized gain or loss on investments is reported in the Statement of Revenue, Expense and Changes in Fund Balance as a component of investment income.

Interest on Educational Loans:
The United States Department of Education makes quarterly interest payments on subsidized loans until the borrower is required to begin repayment under the provisions of the Higher Education Act. For Stafford loans repayment generally begins 6 to 9 months after the student completes his/her course of study, leaves school or fails to carry a minimum academic load. Repayment begins immediately upon full disbursement for Consolidation loans, SLS loans and PLUS loans disbursed prior to July 1, 2008. PLUS loan borrowers with loans disbursed on or after July 1, 2008 may choose to begin repayment 6 months after the student ceases to be enrolled at least half-time.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Special Allowance Payments:
The United States Department of Education provides a special allowance or subsidy to lenders participating in the Federal Family Education Loan Program. Conversely, if the interest rate is above the guaranteed interest, the excess portion of the borrower payment is remitted to the Federal government. This allowance is paid on the average quarterly unpaid principal balance of student loans, based on an annual rate equal to the average yield rate of 91-day U. S. Treasury Bills or 3-month Commercial Paper Rates for that quarter increased by various rates, depending on loan origination date. If the average yield rate is lower than the interest rate paid by the borrower, then the excess portion of the borrower payment is rebated to the federal government. A minimum yield of 9.5% exists on certain loans purchased with tax-exempt funds. As of June 30, 2010, rebates of $24,918,668 were netted in Special Allowance revenue on the financial statements.

During the year ended June 30, 2010, the Income Based Repayment (IBR) Plan was enacted as part of the College Cost Reduction and Access Act of 2007. IBR is a repayment plan option for borrowers with loans in the Direct Loan Program or the Federal Family Education Loan Program (FFELP). The IBR plan may result in servicers receiving additional subsidy payments on behalf of borrowers and potential reimbursement for any discharge by the federal government of remaining debt balances for borrowers at the end of 25 years.

Allowance for Uncollectible Loans:
The educational loans receivable are loan portfolios purchased from various banks and other financial institutions as well as loans originated by MHESAC. Under contracts with the Montana Guaranteed Student Loan Program (MGSLP), other non-Montana guarantors and the United States Department of Education, MHESAC is guaranteed reimbursement of principal and accrued interest on defaulted educational loans for which the applicable due diligence procedures have been performed. The Corporation receives 100% reimbursement on loans disbursed prior to October 1, 1993. Loans disbursed after that date are reimbursed at 97%. A provision for uncollectible educational loans has been made for the years ended June 30, 2010 and 2009 based on the average claim rate as of year-end.

Deferred Bond Issuance Costs:
Bond issuance costs are capitalized and are amortized using the effective interest method over the life of the bonds. Unamortized bond issuance costs associated with bonds redeemed prior to maturity dates are expensed at the time of redemption.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contingent Excess Interest Liability:
MHESAC is bound by IRS regulations that require tax exempt bond issuers to rebate educational loan earnings that exceed specified limits. Such excess earnings may be rebated to the U.S. Treasury or to educational loan borrowers. It is MHESAC's intention to rebate all excess earnings to borrowers. The liability is booked at current value.

The financial statements reflect a calculation based on loans currently owned and present a liability at the balance sheet date. Indenture requirements mandate that sufficient funds or loans are reserved to cover the liability at its estimated future value. (See Note 6).

Derivative Instruments:
The Corporation holds and issues derivative financial instruments for the purpose of hedging the risks relating to the changes in interest rates. The Corporation documents its risk management strategy and hedge effectiveness at the inception of and during the term of each hedge. The type of hedge that the Corporation uses are interest rate swaps. The purpose of these instruments is to hedge the fair value of fixed rate debt in MHESAC fixed rate financings and cash flows of variable rate debt in MHESAC variable rate financings.

The Corporation believes the use of these swaps hedges a minimum spread between the bond interest cost and any fixed rate component of the return on student loans securing those bonds. The Corporation holds and issues such derivatives only for the purpose of hedging such risks, not for speculation. At June 30, 2009, hedging relationships existed for bond indebtedness; however, those relationships matured during the year ended June 30, 2010.

At June 30, 2009, all existing derivatives were designated and qualified as cash flow hedging instruments and were reported at fair value. Accounting principles require the swaps to be carried at fair value at the balance sheet date. The gain or loss on the hedge is reported as a component of non-operating income. Net payments under the swap agreements are reported as a component of bond interest expense in the statement of revenue, expense and changes in fund net assets. See Note 7 for additional terms of the instruments.

GASB adopted Statement No. 53, Accounting and Financial Reporting for Derivative Instruments in June 2008. Statement No. 53 is applicable for periods starting after June 15, 2009 with early implementation encouraged. MHESAC already follows the fair valuation and disclosure requirements of the guidance and for consistency will report the change in value as a non-operating income. The remaining instruments at June 30, 2009 expired during fiscal year 2010.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contingent Arbitrage Rebate Liability:
Internal Revenue Service regulations require that tax-exempt bond issuers rebate investment earnings that exceed specified limits to the U.S. Treasury. Limits vary depending on the bond issue date. Such excess earnings are determined annually and the cumulative excess is payable on every fifth anniversary date of the bonds' issuance, and on final maturity of the bonds. At June 30, 2010, the Corporation's arbitrage rebate liability was $5,936,524.

Restricted Fund Net Assets:
Restricted fund net assets represent revenue bond funds that are required to be expended only as prescribed by the bond indenture. Due to the limited obligation nature of this debt, the funds and accounts established by the indenture are pledged as collateral for the bonds under the indenture.

Reclassifications:
Certain reclassifications were made to the 2009 financial statements in order to conform to the 2010 presentation. The reclassifications had no effect on net assets or total assets previously reported.

NOTE 2. INVESTMENTS

Since the restricted funds are governed by a bond indenture, the Corporation adheres to the requirements specified within the bond indenture for investment activity of those funds. The Corporation has adopted a formal internal policy related to the investment of the General Fund activity that is in accordance with the Internal Revenue Code and the prudent expert principle. General Fund moneys will be invested in securities similar in nature to those in the indenture. Pledged revenues and other amounts in the pledged funds and accounts that are not invested in financed student loans are used to acquire investment agreements with one or more investment agreement providers. The quality rating of the obligations of the provider of the investment contracts must be maintained at a level defined by each agreement using standard ratings by Standard and Poor’s, Moody’s or Fitch. The bond trustee monitors compliance with the established quality ratings and the provider is required to provide prompt notice if any credit event occurs that adversely affects the minimum quality rating.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Corporation or bond trustee, and are held by either the counterparty or the counterparty’s trust department or agent but not in the Corporation’s or bond trustee’s name.

NOTE 2. INVESTMENTS (CONTINUED)

The Corporation does not have any custodial credit risk as all securities are held in its name. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit risk. In addition, investment contracts are not considered securities for purposes of credit risk classification.

Investments issued or guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from concentration of credit risk disclosure requirements.

Interest rate risk is the risk that interest rate changes will adversely affect the fair value of an investment. The Corporation utilizes the specific identification method in regard to interest rate risk as evidenced by the listing of each specific investment and the related interest rates in the chart below. Investment maturities are structured to meet cash requirements for bond redemption schedules as outlined in the indenture.

The Corporation's investments are reported at fair value. The following summarizes investments held at June 30, 2010:

INVESTMENTS – CURRENT	AMOUNT	RATE	MATURITY
Freddie Mac Note	$ 357,105	5.25%	07/18/11
Federal Home Loan Bank Note	515,968	1.63%	11/25/11
	873,073		
INVESTMENTS – RESTRICTED			
Investment Agreements:			
Bayerische Landesbank Girozentrale			
1998A Reserve and Float Funds	2,110,387	1.99%	12/01/31
1998B Reserve and Float Funds	736,434	5.53%	12/01/31
1999B Float Funds	101,475	6.20%	12/01/32
1999B Reserve Funds	1,017,500	6.35%	12/01/32
2000D Reserve Funds	409,000	6.27%	12/01/10
2000A&B Reserve Funds	5,000,000	1.93%	12/01/33
2000A&B Float Funds	1,217,040	1.93%	12/01/33
2000D Float Funds	138,091	5.91%	12/01/10
2000C Reserve Funds	431,750	0.05%	12/01/33
2000C Float Funds	49,160	0.05%	12/01/33
2001A&B Reserve Funds	5,460,000	1.28%	11/30/15
2001A&B Float Funds	98,321	0.97%	11/30/15
2001C Reserve Funds	883,500	0.26%	11/30/15
2001C Float Funds	103,539	0.17%	11/30/15
2004A,B&C Float Funds	224,517	0.97%	11/27/15
Bayerische Landesbank Girozentrale Total	17,980,714		

NOTE 2. INVESTMENTS (CONTINUED)

INVESTMENTS – RESTRICTED (CONTINUED)

Investment Agreements (Continued):

UniCredit Bank AG (formerly Bayerische-Hypo)	AMOUNT	RATE	MATURITY
1999A Reserve Funds	4,075,000	1.71%	12/01/32
1999A Float Funds	406,400	1.21%	12/01/32
UniCredit Bank AG Total	4,481,400		
Trinity Funding Company			
2002A,B&E Float Funds	120,085	0.30%	11/30/35
2002D Float Funds	42,023	0.30%	11/30/35
2005 Float Funds	570,913	0.44%	06/19/30
2006A Float Funds	407,877	0.39%	03/19/24
2006B&C Float Funds	188,313	0.20%	01/30/38
2006D,E,F&G Float Funds	2,323,433	0.27%	01/29/38
Trinity Funding Company Total	3,652,644		
Grand Central Funding			
2003A,B&D Float Funds – Variable	199,046	1.24%	11/28/36
2003C Float Funds	64,645	0.28%	11/28/36
Grand Central Funding Total	263,691		
	26,378,449		
TOTAL INVESTMENTS	$ 27,251,522		

Investment Provider Ratings:	S&P	Moody's	Fitch
Bayerische Landesbank Girozentrale	Not Rated	A1/P-1	A+/F1+
UniCredit Bank AG	A/A-1	A1/P-1	A+/F1+
Trinity Funding Company	AA+/A-1+	Aa2/P-1	Not rated
Grand Central Funding	Not rated	Aaa/P-1	AAA/F1+

NOTE 3. EDUCATIONAL LOANS RECEIVABLE

The educational loans receivable are classified as student/interim or repayment status. Student/interim status represents the period from the date the educational loan is made until a student is out of school, including the grace period and any authorized deferment periods, at which time repayment status commences. The educational loans receivable are disclosed in the financial statements net of allowances for uncollectible loans.

NOTE 3. EDUCATIONAL LOANS RECEIVABLE (CONTINUED)

Educational loans are summarized as follows:

	June 30, 2010	June 30, 2009
Student/interim status	$ 581,415,245	$ 672,673,921
Repayment status	927,201,246	903,585,271
Educational loans receivable	1,508,616,491	1,576,259,192
Allowance for uncollectible loans	(733,060)	(604,279)
Educational loans receivable, net	$ 1,507,883,431	$ 1,575,654,913

In addition to the special allowance paid by the federal government on certain loans, payments of principal and interest are made using the various rates and terms for loans outstanding.

Depending on factors specified in the Higher Education Act, educational loans have either fixed or variable interest rates and various maximum repayment terms. As of June 30, 2010, fixed interest rates on Stafford, PLUS, SLS, and FISL loans in the portfolio varied from 5.6% for subsidized loans originated after July 1, 2009 to 12%. Fixed interest rates to the borrower on Consolidation loans are based upon the weighted average interest rates of the loans consolidated rounded up to the nearest one-eighth or whole percentage depending on the disbursement date. Consolidation loans disbursed on or after November 13, 1997 have a maximum interest rate of 8.25%.

Variable interest rates are based upon either the 91 day or one year constant maturity Treasury bill, subject to maximum interest rates ranging from 7% to 12%. All Stafford and PLUS loans disbursed on or after July 1, 1994 and before July 1, 2006 are variable rate and have maximum interest rates of 8.25% and 9%, respectively. Stafford loans disbursed after July 1, 2006 have a fixed rate to the borrower of 6.8%, except subsidized Stafford loans issued between July 1, 2008 and June 30, 2009 and July 1, 2009 and June 30, 2010, which bear interest at the fixed rate of 6% and 5.6%, respectively. PLUS loans disbursed after July 1, 2006 have a fixed rate to the borrower of 8.5%. SLS, PLUS, and FISL loans have a maximum repayment term of 10 years. Stafford loans have maximum repayment terms of 10 or 25 years depending on the borrower's original disbursement date. Consolidation loans have maximum repayment terms of 10 to 30 years depending on original balance.

NOTE 3. EDUCATIONAL LOANS RECEIVABLE (CONTINUED)

Sale of Student Loans
MHESAC participated in the PUT (Loan Purchase Commitment Program) program on June 25, 2010. The Department of Education is authorized to purchase federal student loans from lenders to ensure on-going availability of funds for student loans. MHESAC sold $98,966,399 in loans from the 2007 bond series that were originated in fiscal year 2010. The sale of loans resulted in a gain of $1,949,100 from the reimbursement by the Department of Education of $75 per loan for previously incurred loan origination costs. The Department of Education also reimbursed 1% of lender loan fees originally paid by MHESAC.

NOTE 4. RELATED PARTY TRANSACTIONS

MHESAC has entered into agreements with Student Assistance Foundation of Montana (SAF) to provide management and loan servicing to MHESAC. SAF has three of its nine Board members in common with the Corporation's seven Board members. Effective February 1, 2000, the Corporation transferred, for fair value, all of its operations and non-financial assets including personnel, all furniture and equipment, as well as its interest in the office building, to SAF. The note for the sale of land and building bears interest at a fixed rate of 8.22% and is an 18 year note.

Following are details of the financial transactions between MHESAC and SAF:

Sale of real estate and building for which note was received	$ 2,900,000
Principal payments received through June 30, 2010	(839,128)
Balance due MHESAC on real estate note	$ 2,060,872
Less current portion	(177,166)
Long-term receivable balance at June 30, 2010	$ 1,883,706

On June 28, 2003, Montana Student Loan Funding, LLC (MSLF) was created as a limited liability corporation with SAF as the sole member. MSLF is a bankruptcy remote company created to acquire and originate student loans and has a perpetual life. Previously, the loan activity conducted by MSLF was for the specific purpose of an eventual sale to MHESAC with no obligation by MHESAC to acquire the loans until it was able to obtain financing for that specific purpose.

NOTE 4. RELATED PARTY TRANSACTIONS (CONTINUED)

The indenture required a purchase of student loans at a purchase price to include 100% of the outstanding unpaid principal balance on the loan on the loan purchase date plus accrued borrower interest. In addition, the purchase price would include a premium mutually agreed upon between MSLF and MHESAC designed to recover acquisition costs incurred and provide a nominal level of profit on the activity to MSLF.

MHESAC previously acquired two large portfolios in 2005 and 2006 from MSLF. Due to dramatic changes in the economic environment and MSLF's financial position in the indenture, it is not MHESAC's intent to obtain financing or purchase the MSLF loan portfolio. Prepaid costs of $1,637,373 associated with potential acquisition of these loans were expensed by MHESAC during the year ended June 30, 2009. The portfolio balance MSLF held at June 30, 2010 was $207 million.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE

Educational Loan Revenue Bonds Payable:
The bonds outstanding are summarized in the table below.

Bonds outstanding at June 30, 2009	$ 1,828,999,846
Bonds issued during the year	-
Bonds accreted during the year	57,154
Bonds redeemed during the year	(194,716,000)
Bonds acquired & retired during the year	(33,450,000)
Bonds outstanding at June 30, 2010	$ 1,600,891,000

A description of significant terms and conditions of each Student Loan Revenue Bond issue outstanding at June 30, 2010 follows:

Issue	Year End Interest Rate	Original Issue Amount	June 30, 2010
Tax Exempt Fixed Rate Bonds:			
1998 Series B Bonds **	4.85-5.50%	$ 27,970,000	$ 23,585,000
1999 Series B Bonds **	5.45-6.40%	20,350,000	18,225,000
2000 Series D Bonds **	5.10%	8,180,000	1,375,000
Total Tax Exempt Fixed Rate Bonds		56,500,000	43,185,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Issue	Year End Interest Rate	Original Issue Amount	June 30, 2010
Tax Exempt Auction Rate Bonds:			
1995 Series A Bonds	0.508%	56,700,000	34,600,000
1995 Series B Bonds	0.560%	56,600,000	34,500,000
1995 Series C Bonds	0.543%	56,600,000	22,200,000
1998 Series A Bonds	0.508%	79,800,000	76,700,000
1999 Series A Bonds	0.508%	81,500,000	81,500,000
2000 Series A Bonds	0.508%	50,000,000	50,000,000
2000 Series B Bonds	0.560%	50,000,000	50,000,000
2001 Series A Bonds	0.455%	84,200,000	84,200,000
2001 Series B Bonds	0.455%	25,000,000	14,000,000
2002 Series A Bonds	0.508%	53,800,000	53,800,000
2002 Series B Bonds	0.508%	29,000,000	29,000,000
2002 Series E Bonds **	0.508%	15,000,000	15,000,000
2003 Series A Bonds	0.543%	80,200,000	75,200,000
2003 Series B Bonds	0.508%	80,100,000	80,100,000
2003 Series D Bonds **	0.543%	10,000,000	10,000,000
2004 Series A Bonds	0.455%	83,000,000	83,000,000
2004 Series B Bonds	0.508%	83,000,000	83,000,000
2004 Series C Bonds **	0.455%	12,000,000	12,000,000
2006 Series D Bonds	0.508%	71,400,000	71,400,000
2006 Series E Bonds	0.560%	71,400,000	71,400,000
2006 Series F Bonds	0.543%	71,300,000	66,300,000
2006 Series G Bonds **	0.543%	20,000,000	20,000,000
Total Tax Exempt Auction Rate Bonds		1,220,600,000	1,117,900,000
Tax Exempt VRDO Bonds:			
2007 Series A Bonds	5.5%	105,000,000	5,600,000
2007 Series B Bonds	5.5%	35,000,000	1,860,000
2007 Series C Bonds	5.5%	35,000,000	1,860,000
Total Tax Exempt VRDO Bonds		175,000,000	9,320,000
Taxable Floating Rate Notes:			
2005 Series A Bonds	0.579%	133,508,000	13,602,000
2005 Series B Bonds	0.659%	119,140,000	119,140,000
2006 Series A Bonds	0.639%	226,775,000	201,394,000
Total Taxable Floating Rate Notes:		479,423,000	334,136,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Issue	Year End Interest Rate	Original Issue Amount	June 30, 2010
Taxable Auction Rate Bonds:			
2000 Series C Bonds	1.851%	11,200,000	9,050,000
2001 Series C Bonds	1.851%	29,500,000	20,800,000
2002 Series D Bonds	1.850%	10,300,000	8,000,000
2003 Series C Bonds	1.848%	13,300,000	10,100,000
2006 Series B Bonds	1.847%	74,700,000	18,400,000
2006 Series C Bonds **	0.296%	30,000,000	30,000,000
Total Taxable Auction Rate Bonds		169,000,000	96,350,000
TOTAL BONDS		$ 2,100,523,000	$1,600,891,000

The Bonds are limited obligations of the Corporation payable solely from and secured by specific revenues and funds as described in the indenture. Of the outstanding bonds, $1,170,405,000 are tax-exempt and $430,486,000 are taxable.

** These bonds are classified as subordinate bonds and all other bonds reported have payment and certain other priorities over these bonds.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Original Issue Date	Average Interest Rate from Issuance Date to Current	Maturity Date	Interest Due Status	Variable Rate Basis	June 30, 2010
3/16/1995	3.15%	12/1/2015	Semi-annual	35 day auction	$ 34,600,000
3/16/1995	3.15%	12/1/2015	Semi-annual	35 day auction	34,500,000
3/16/1995	3.19%	12/1/2015	Semi-annual	35 day auction	22,200,000
12/1/1998	2.69%	12/1/2031	Semi-annual	35 day auction	76,700,000
11/1/1998	4.85%	12/1/2010	Semi-annual	N/A-Fixed rate	325,000
11/1/1998	4.95%	12/1/2011	Semi-annual	N/A-Fixed rate	670,000
11/1/1998	5.00%	12/1/2012	Semi-annual	N/A-Fixed rate	580,000
11/1/1998	5.50%	12/1/2031	Semi-annual	N/A-Fixed rate	22,010,000
12/1/1999	2.54%	12/1/2032	Semi-annual	35 day auction	81,500,000
11/1/1999	5.45%	12/1/2010	Semi-annual	N/A-Fixed rate	280,000
11/1/1999	5.55%	12/1/2011	Semi-annual	N/A-Fixed rate	295,000
11/1/1999	5.65%	12/1/2012	Semi-annual	N/A-Fixed rate	465,000
11/1/1999	5.75%	12/1/2013	Semi-annual	N/A-Fixed rate	480,000
11/1/1999	5.85%	12/1/2014	Semi-annual	N/A-Fixed rate	505,000
11/1/1999	6.40%	12/1/2032	Semi-annual	N/A-Fixed rate	16,200,000
9/7/2000	2.41%	12/1/2033	Semi-annual	35 day auction	50,000,000
9/7/2000	2.44%	12/1/2033	Semi-annual	35 day auction	50,000,000
9/7/2000	2.98%	12/1/2033	Every 28 days	28 day auction	9,050,000
8/1/2000	5.10%	12/1/2010	Semi-annual	35 day auction	1,375,000
11/28/2001	2.22%	12/1/2034	Semi-annual	35 day auction	84,200,000
11/28/2001	2.18%	12/1/2034	Semi-annual	35 day auction	14,000,000
11/28/2001	2.71%	12/1/2034	Every 28 days	28 day auction	20,800,000
11/6/2002	2.41%	12/1/2035	Semi-annual	35 day auction	53,800,000
11/6/2002	2.40%	12/1/2035	Semi-annual	35 day auction	29,000,000
11/6/2002	2.77%	12/1/2035	Every 28 days	28 day auction	8,000,000
11/6/2002	2.48%	12/1/2035	Semi-annual	35 day auction	15,000,000
10/15/2003	2.54%	12/1/2037	Semi-annual	35 day auction	75,200,000
10/15/2003	2.59%	12/1/2037	Semi-annual	35 day auction	80,100,000
10/15/2003	3.02%	12/1/2037	Every 28 days	28 day auction	10,100,000
10/15/2003	2.62%	12/1/2037	Semi-annual	35 day auction	10,000,000
11/17/2004	2.82%	12/1/2038	Semi-annual	35 day auction	83,000,000
11/17/2004	2.78%	12/1/2038	Semi-annual	35 day auction	83,000,000
11/17/2004	2.90%	12/1/2038	Semi-annual	35 day auction	12,000,000
5/26/2005	4.10%	6/20/2015	Quarterly	3 mth Libor + 4 basis points	13,602,000
5/26/2005	3.45%	6/20/2030	Quarterly	3 mth Libor + 12 basis points	119,140,000
5/3/2006	3.35%	3/20/2024	Quarterly	3 mth Libor + 10 basis points	201,394,000
5/3/2006	4.14%	12/1/2040	Every 7 days	7 day auction	18,400,000
5/3/2006	2.72%	12/1/2040	Every 28 days	28 day auction	30,000,000
10/31/2006	3.51%	12/1/2040	Semi-annual	35 day auction	71,400,000
10/31/2006	2.77%	12/1/2040	Semi-annual	35 day auction	71,400,000
10/31/2006	2.74%	12/1/2040	Semi-annual	35 day auction	66,300,000
10/31/2006	2.78%	12/1/2040	Semi-annual	35 day auction	20,000,000
12/17/2007	2.17%	12/1/2042	Semi-annual	Prime Rate + 2.25%	5,600,000
12/17/2007	2.19%	12/1/2042	Semi-annual	Prime Rate + 2.25%	1,860,000
12/17/2007	2.21%	12/1/2042	Semi-annual	Prime Rate + 2.25%	1,860,000
					$ 1,600,891,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2005 – 2007 Bonds:

2005 Series A and B Student Loan Revenue Bonds
The 2005 Series A and B Bonds have targeted principal balance reduction schedules as follows:

2005 A Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
September 20, 2010	$ 4,689,000	March 20, 2011	$ 4,353,000
December 20, 2010	4,560,000		

2005 B Senior Bonds

June 20, 2011	$ 4,260,000	March 20, 2016	$ 2,954,000
September 20, 2011	4,180,000	June 20, 2016	2,919,000
December 20, 2011	4,114,000	September 20, 2016	2,884,000
March 20, 2012	4,038,000	December 20, 2016	2,850,000
June 20, 2012	3,970,000	March 20, 2017	2,818,000
September 20, 2012	3,906,000	June 20, 2017	2,776,000
December 20, 2012	3,849,000	September 20, 2017	2,731,000
March 20, 2013	3,788,000	December 20, 2017	2,699,000
June 20, 2013	3,715,000	March 20, 2018	2,670,000
September 20, 2013	3,666,000	June 20, 2018	2,640,000
December 20, 2013	3,623,000	September 20, 2018	2,610,000
March 20, 2014	3,577,000	December 20, 2018	2,580,000
June 20, 2014	3,503,000	March 20, 2019	2,551,000
September 20, 2014	3,416,000	June 20, 2019	2,523,000
December 20, 2014	3,374,000	September 20, 2019	2,494,000
March 20, 2015	3,335,000	December 20, 2019	2,465,000
June 20, 2015	3,089,000	March 20, 2020	2,437,000
September 20, 2015	3,029,000	June 20, 2020	2,345,000
December 20, 2015	2,989,000	September 20, 2020	1,773,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

2006 Series A Student Loan Revenue Bonds

The 2006 Series A Bonds have a targeted principal balance reduction schedule as follows:

2006 A Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
September 20, 2010	$20,564,000	June 20, 2014	$ 6,966,000
December 20, 2010	5,871,000	September 20, 2014	6,923,000
March 20, 2011	6,185,000	December 20, 2014	6,990,000
June 20, 2011	6,265,000	March 20, 2015	6,928,000
September 20, 2011	6,238,000	June 20, 2015	7,043,000
December 20, 2011	6,573,000	September 20, 2015	6,910,000
March 20, 2012	6,611,000	December 20, 2015	6,934,000
June 20, 2012	6,679,000	March 20, 2016	6,809,000
September 20, 2012	6,682,000	June 20, 2016	6,639,000
December 20, 2012	6,839,000	September 20, 2016	6,228,000
March 20, 2013	6,893,000	December 20, 2016	6,166,000
June 20, 2013	6,890,000	March 20, 2017	6,005,000
September 20, 2013	6,846,000	June 20, 2017	5,672,000
December 20, 2013	6,969,000	September 20, 2017	2,109,000
March 20, 2014	6,967,000		

The targeted principal reduction amounts for the 2006 Series A were not fully met December 20, 2008, March 20, 2009, June 20, 2009, September 20, 2009, December 20, 2009, March 20, 2010 and June 20, 2010. The anticipated principal reduction amount for September 20, 2010 includes $15,097,000 in carry-over principal reduction.

2007 Series A, B and C Student Loan Revenue Bonds

Through October 6, 2008, the Series A, B and C Bonds bore interest at variable rates every 7 days as determined by the respective Remarketing Agent for the individual series. The Series A, B, and C received notice on October 6, 2008 from their respective Remarketing Agents that the bonds had not been remarketed and were subsequently purchased by the Liquidity Provider. Per the First Amendment to the Standby Bond Purchase Agreement, the interest rate on the Series A, B and C Bonds is based on the daily 1-month LIBOR rate plus 75 basis points until and including October 1, 2009.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

2007 Series A, B and C Student Loan Revenue Bonds (Continued)

Beginning October 1, 2009 the interest rate was based upon prime rate and was thus 3.25%. Beginning December 31, 2009, the interest rate was based on prime rate plus 2.25%.

Per the Standby Bond Purchase Agreement, on the date such Bonds become Bank Bonds, the issuer will cause the redemption of the Bonds in equal semiannual principal installments until the Bonds are paid in full no later than the 30th anniversary of the Bank Purchase Date. The Series A Bonds semiannual principal installment in the amount of $1,750,000 and the Series B and C Bonds semiannual principal installments in the amount of $585,000 commenced December 1, 2008. The principal reduction installments totaled $5,840,000 for the year ended June 30, 2010.

Acquisition and Retirements:

During the year ended June 30, 2010, the Corporation had scheduled redemptions and special redemptions of student loan revenue bonds. The redemptions are summarized in the tables below:

Scheduled Redemptions:

Bond Series	Redemption Date	Redemption Amount
2005 Series A	09/20/2009	$ 5,156,000
2006 Series A	09/20/2009	2,296,000
1995 Series E	12/01/2009	2,195,000
1998 Series B	12/01/2009	380,000
1999 Series B	12/01/2009	490,000
2000 Series D	12/01/2009	1,295,000
2007 Series A	12/01/2009	1,750,000
2007 Series B	12/01/2009	585,000
2007 Series C	12/01/2009	585,000
2005 Series A	12/20/2009	5,055,000
2006 Series A	12/20/2009	3,109,000
2005 Series A	03/20/2010	4,931,000
2006 Series A	03/20/2010	2,608,000
2007 Series A	06/01/2010	1,750,000
2007 Series B	06/01/2010	585,000
2007 Series C	06/01/2010	585,000
2005 Series A	06/20/2010	4,775,000
2006 Series A	06/20/2010	2,586,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Special Redemptions:

Bond Series	Acquisition Date	Par Value	Purchase Price	Gain
2007 Series A	09/29/2009	14,400,000	14,400,000	-
2007 Series B	09/29/2009	4,800,000	4,800,000	-
2007 Series C	09/29/2009	4,800,000	4,800,000	-
2007 Series A	03/23/2010	24,000,000	24,000,000	-
2007 Series B	03/23/2010	8,000,000	8,000,000	-
2007 Series C	03/23/2010	8,000,000	8,000,000	-
2007 Series A	06/30/2010	54,000,000	54,000,000	-
2007 Series B	06/30/2010	18,000,000	18,000,000	-
2007 Series C	06/30/2010	18,000,000	18,000,000	-

Bond Redemptions by Acquisition and Retirement:

Bond Series	Acquisition Date	Par Value	Purchase Price	Gain
2000 Series C	08/19/2009	150,000	128,250	21,750
1995 Series C	08/20/2009	12,300,000	10,516,500	1,783,500
2001 Series B	09/29/2009	11,000,000	9,350,000	1,650,000
2003 Series A	06/04/2010	5,000,000	4,400,000	600,000
2006 Series F	06/04/2010	5,000,000	4,400,000	600,000

Summary of Maturities:

The following is a summary of stated maturities and mandatory sinking fund requirements on long-term debt:

Year Ending June 30	Revenue Bonds Payable	Interest	Total
2011	$ 68,047,000	$ 47,086,762	$ 115,133,762
2012	43,368,000	47,015,720	90,383,720
2013	43,607,000	46,962,837	90,569,837
2014	42,597,000	46,923,708	89,520,708
2015	41,603,000	46,894,974	88,497,974
2016-2020	198,736,000	218,978,329	417,714,329
2021-2025	1,773,000	217,220,259	218,993,259
2026-2030	-	183,516,974	183,516,974
2031-2035	424,460,000	141,456,170	565,916,170
2036-2040	459,200,000	72,374,037	531,574,037
2041-2042	277,500,000	4,006,830	281,506,830
Total	$1,600,891,000	$1,072,436,600	$ 2,673,327,600

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Compliance:
The bond indentures contain several covenants. These covenants include minimum reserve requirements, restrictions and limitations related to administrative expenses and minimum spending requirements for the purchase of educational loans. The Corporation is substantially in compliance with the covenants of the bond indentures outstanding at June 30, 2010.

Auction Rate Bond Provisions for Illiquid Auctions:
In the event of a bond auction being illiquid, there is a provision in the Indenture that states the interest rate for tax-exempt auction bonds shall be equal to the Maximum Auction Rate and the interest rate for taxable auction bonds will be the lesser of the Net Loan Rate or the Maximum Auction Rate. During the fiscal year ending June 30, 2008 this provision went into effect due to Auction liquidity issues. Since June 30, 2008, all auction bonds have continued to be illiquid on each auction date except the 2006C bond series that had three successful auctions where the auction rate exceeded the net loan rate during the fiscal year ended June 30, 2010.

The Maximum Auction Rate, for the tax-exempt auction bond series, is determined by terms specified in the Indenture that consider Bond ratings, the Composite Commercial Paper rate, the SIFMA Index and the Statutory Corporate Tax Rate. The indenture provides specific calculation methodologies that use combinations of the above mentioned criteria to determine the interest rate for the 35 day auction period.

Per Indenture terms, the taxable auction bond series are subject to an interest rate limitation of the lesser of the Net Loan Rate or the Maximum Auction Rate. Net Loan Rate is determined by specific indenture calculation methodologies that use a combination of average 91-day T-bills and Auction rates to determine the interest rate for the 7 or 28 day auction period. Maximum Auction Rate, for the taxable bond series, is calculated based on One-Month LIBOR plus a percentage based on the bond rating.

When the interest rate limitation is the Net Loan Rate, a Carry-Over Amount is calculated accruing the difference between the amount of interest paid using the Net Loan Rate and the amount of interest due if the taxable Maximum Auction Rate was used. The Carry-Over Amount is payable subject to terms in the Indenture and will bear interest calculated using One-Month LIBOR. Per Indenture terms, when the net loan rate exceeds the auction rate the issuer is required to pay down the prior accrued Carry-Over subject to Surplus fund availability. Surplus funds were not available during the year ended June 30, 2010. At June 30, 2010 the Corporation’s Carry-Over liability was $4,364,517 and is included in these statements as a long term liability. Due to bond Acquisition and retirement activity in the 2000C bond series, there was a $4,182 forgiveness of Carry-Over liability.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Variable Rate Demand Obligations
The Variable Rate Demand Obligations (VRDO) issued in December 2007 are not subject to the same maximum auction rate provisions that the auction rate bonds are as noted above. The VRDOs have a liquidity provision in the form of a standby bond purchase agreement that provides a guarantee of a funding source should any bondholder decide to put their bond. This standby bond purchase agreement went into effect October 6, 2008 and the bonds were purchased by the liquidity provider.

NOTE 6. CONTINGENT EXCESS INTEREST LIABILITIES

Excess Interest:
Internal Revenue Service regulations require that tax exempt bond issuers rebate educational loan earnings that exceed specified limits. Such excess earnings may be rebated to the U.S. Treasury or to educational loan borrowers. Limits vary depending on the bond issue date. For bonds issued prior to July 1, 1993, such excess earnings are determined annually with 50% of the cumulative excess payable within sixty (60) days of the tenth anniversary date of the bond issuance. Within sixty (60) days after every subsequent fifth anniversary of the issuance date, 75% of the cumulative excess is payable and within sixty (60) days after final retirement of the bond issue, 100% of the cumulative excess is payable.

For all other bonds, such excess earnings are determined annually and 75% of the cumulative excess is payable within sixty (60) days of the tenth anniversary date of bond issuance and every subsequent fifth anniversary date with 100% payable within sixty (60) days after final retirement of the bond issue. During fiscal year 2009 and 2010, the excess interest liability decreased due to financial market fluctuations. At June 30, 2010, the Corporation's excess interest liability was $788,839. It is the Corporation’s intent to rebate all excess earnings to borrowers and a plan is in place to do so.

Based on the above regulations for payment of excess interest liabilities, the following is a summary by fiscal year of when the reported liabilities would be due if there were no plan to rebate the excess interest to borrowers:

2013	$ 308,803
2014	282,827
Subsequent years	197,209
	$ 788,839

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Corporation follows the guidance established for measuring fair value under GAAP and related disclosure requirements. As such fair value is considered the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date in the principal or most advantageous market for the specific asset or liability.

Fair value measurement assumes the highest and best use of the asset by market participants and requires valuation techniques that maximize use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy prioritizes valuation inputs into three broad levels:

Level 1 – Quoted prices in active markets for identical assets or liabilities;

Level 2 – Significant observable inputs other than Level 1 such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active, or inputs other than quoted prices that are observable or can be corroborated by observable market data. This level input must be observable for substantially the full term of the assets or liabilities;

Level 3 – Significant unobservable inputs for situations in which there is little, if any, market activity.

The following are the assets and liabilities measured on a recurring basis as of and for the year ended June 30, 2010 and 2009:

Financial Instrument:	Carrying Value	Fair Value	Quoted Prices in Active Markets - Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2010:					
Assets:					
Investment Securities					
Federal Home Loan Bank Notes	$ 515,968	$ 515,968	$ -	$ 515,968	$ -
Freddie Mac	357,105	357,105	-	357,105	-
Guaranteed Investment Contracts	26,378,449	26,378,449	-	-	26,378,449
	$ 27,251,522	$ 27,251,522	$ -	$ 873,073	$ 26,378,449
2009:					
Assets:					
Investment Securities					
Federal Home Loan Bank Notes	$ 517,256	$ 517,256	$ -	$ 517,256	$ -
Freddie Mac	366,775	366,775	-	366,775	-
Guaranteed Investment Contracts	87,500,859	87,500,859	-	-	87,500,859
	$ 88,384,890	$ 88,384,890	$ -	$ 884,031	$ 87,500,859
Liabilities:					
Interest Rate Swap Agreements	$ 450,512	$ 450,512	$ -	$ 450,512	$ -

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following valuation methods are used to determine the fair value of the above items on a recurring basis, which did not change in 2010:

Investment Securities and Contracts:
Fair value for securities and balances of investment contracts are based on market prices provided by the Bond Trustee managing the investments or the contract provider.

Interest Rate Swap Agreement:
The Corporation previously entered into several interest rate swap agreements. Interest rate swaps involve the periodic exchange of payments without the exchange of underlying principal or notional amounts. Settlement of the swaps is done on each June 1 and December 1. The fair value of the interest rate swaps is the estimated amount that the Company would receive or pay to terminate the swap agreements at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

During the year ending June 30, 2010, the remaining interest rate swap agreements for Bond Series 1998A, 1999A and 2001A matured on August 27, 2009 and final payments of $696,032 were made to the swap counterparties during the year. At June 30, 2010, there were no interest rate swap agreements outstanding.

Following is a reconciliation of beginning and ending values for Level 3 items, consisting of guaranteed investment contracts:

	2010	2009
Fair Value at July 1	**$ 87,500,859**	$ 194,555,319
Receipts/Inflows	**157,754,898**	171,086,570
Payments/Outflows	**(218,877,308)**	(278,141,030)
Fair Value at June 30	**$ 26,378,449**	$ 87,500,859

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

GAAP also requires disclosure of estimated fair values for other financial instruments recognized at amounts other than fair value and the methods used to determine those values:

	2010		2009	
Financial assets:	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Cash and cash equivalents	**$ 51,431,000**	**$ 51,431,000**	$ 139,442,000	$ 139,442,000
Interest receivable	**22,755,000**	**22,755,000**	22,961,000	22,961,000
Real estate loan receivable	**2,060,872**	**2,060,872**	2,223,919	2,223,919
Educational loans receivable, net	**1,507,883,431**	**1,447,378,685**	1,575,654,913	1,575,654,913
Total financial assets	**$ 1,584,130,303**	**$ 1,523,625,557**	$ 1,740,281,832	$ 1,740,281,832
Financial liabilities:				
Interest payable	**$ 5,195,000**	**$ 5,195,000**	4,870,000	4,870,000
Educational bonds payable	**1,600,891,000**	**1,446,678,899**	1,828,999,846	1,828,999,846
	$ 1,606,086,000	**$ 1,451,873,899**	$ 1,833,869,846	$ 1,833,869,846

The following is a description of the methods used to estimate the above fair values:

Cash and Cash Equivalents:
The carrying amount for cash and cash equivalents is considered to approximate fair value at June 30, 2010.

Interest Receivable and Payable:
The carrying amounts of interest receivable and payable are considered to approximate fair value at June 30, 2010 and 2009, given their short-term nature.

Educational Loans Receivable:
The fair value was estimated by reference to sale information from the limited marketplace and by discounting the future cash flows using current rates of return required by investors in similar assets. A number of significant inputs into the models are internally derived and not observable to market participants. The fair value of student loans that were subsequently sold under the Department of Education Loan Purchase Commitment Program is the principal amount outstanding as these loans were sold within 60 days subsequent to the balance sheet date at par value.

Educational Bonds Payable:
The Corporation’s bonds consist of both variable rate and fixed rate debt. Due to disruptions in the United States capital markets, there is not a current active market for the Corporation’s auction rate bonds. The estimated fair value of bonds was determined by discounting the cash flows using current market rates, including a liquidity discount due to the status of the auction rate bond market. The fair value of Educational Loan Revenue Bonds Payable is based on the brokered market for fixed rate bonds.

NOTE 8. COMMITMENTS AND CONTINGENCIES

Management and Servicing Agreements:
MHESAC has entered into management and servicing agreements with Student Assistance Foundation of Montana (SAF). SAF will provide portfolio servicing for a term equal to the life of each of MHESAC's related financings. Management services will be provided to MHESAC for an 18-year term beginning February 1, 2000. The cost of these services will be an amount equal to the allocable cost incurred by SAF in performing its duties and obligations under the agreements plus, for the period prior to February 1, 2003, fifteen percent of those costs.

For each successive three-year period the mark-up percentage of such costs will be mutually agreed upon by MHESAC and SAF, but in no event will it be less than five percent. For the three year period beginning July 1, 2009, MHESAC and SAF agreed to continue the mark-up percentage at fifteen percent along with an efficiency incentive to provide a cost savings sharing opportunity. By contract, the fees are payable in advance for each month. Therefore, an estimate is made of anticipated cost levels and SAF bills MHESAC on that basis with a final adjustment to the advance billing based on actual expenses incurred. During the years ended June 30, 2010 and 2009, SAF billed MHESAC $15,619,548 and $15,452,148, respectively. At June 30, 2010 and 2009, the reconciliation for billed and actual costs resulted in a receivable from SAF of $18,538 and a balance payable to SAF of $328,123, respectively

Loan Purchase Agreements:
The Corporation enters into loan purchase agreements with lenders. Under the agreements, the lenders agree to sell, and the Corporation agrees to purchase, a specific dollar amount of qualified guaranteed educational loans. The purpose of the agreements is to ensure a need exists for the Corporation to continue financing efforts to purchase educational loans. At June 30, 2010, the Corporation had outstanding purchase commitments of $28,573,229.

NOTE 9. SUBSEQUENT EVENTS

Continuing Illiquid Auctions:
Since June 30, 2010, all auction bonds except the 2006C have continued to be illiquid on each auction date, also known as the reset date. As a result, the rates paid to the bondholders on those bonds continue to be set by the formulas as explained in Note 5 Auction Rate Bond Provisions for Illiquid Auctions.

NOTE 9. SUBSEQUENT EVENTS (CONTINUED)

Bond Redemptions by Acquisition and Retirement:
On August 13, 2010, the remaining 2007 Series A, B, and C Bonds were redeemed in their entirety. The amounts are $5,600,000, $1,860,000 and $1,860,000, respectively. (See Note 5).

On July 27, 2010, a partial redemption by acquisition and retirement of $7 million par value of the 2006 Series E bonds occurred at a discounted purchase price. The transaction resulted in a gain of $875,000 and the bonds were retired immediately.

MHESAC participated in the PUT (Loan Purchase Commitment Program) program on August 10, 2011. The Department of Education is authorized to purchase federal student loans from lenders to ensure on-going availability of funds for student loans. MHESAC sold $54 million in loans made for the academic year 09-10 and funded with 2007 acquisition monies.

On August 23, 2010, a partial redemption by acquisition and retirement of $5.3 million par value of the 1995 Series C bonds, $7.5 million par value of the 1998 Series A bonds, $100 thousand par value of the 2002 Series B bonds, $300 thousand par value of 2003 Series B bonds and $27.1 million par value of the 2004 Series A bonds occurred at a discounted purchase price. The transaction resulted in a gain of $3,929,250 and the bonds were retired immediately.

On August 31, 2010, a partial redemption by acquisition and retirement of $1.2 million par value of the 2002 Series B bonds occurred at a discounted purchase price. The transaction resulted in a gain of $135,000 and the bonds were retired immediately.

On September 28, 2010, MHESAC was notified that Fitch Ratings, one of the three rating agencies that issue ratings on MHESAC bonds, lowered its rating of all subordinate bonds from A/LS3 to B/LS3, with a stable outlook. At this time, Fitch again affirmed the AAA rating of all senior bonds. The impact of the ratings action is that the mechanism for calculating the periodic interest rate on the subordinate bonds will change and will be higher.

Management has evaluated subsequent events through September 28, 2010, the date which the financial statements were available for issue and did not identify any further events to disclose.

ACCOMPANYING INFORMATION

DISCOVERY BLOCK • 828 GREAT NORTHERN BOULEVARD • P.O. BOX 1040 • HELENA, MONTANA 59624-1040
TEL: 406.442.1040 • FAX: 406.442.1100 • WEB: www.azworld.com

INDEPENDENT AUDITOR'S REPORT
ON ADDITIONAL INFORMATION

To the Board of Directors
Montana Higher Education
  Student Assistance Corporation
Helena, Montana

Our report on our audit of the basic financial statements of the Montana Higher Education Student Assistance Corporation for the year ended June 30, 2010 appears on page 1. We conducted our audit in accordance with auditing standards generally accepted in the United States of America for the purpose of forming an opinion on the basic financial statements taken as a whole. The combining schedule of assets, liabilities and fund net assets under the 1993 master indenture – restricted funds and combining schedule of revenue, expense and changes in fund net assets under the 1993 master indenture – restricted funds are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied 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.

Anderson ZurMuehlen & Co., P.C.

Helena, Montana
September 28, 2010

(THIS PAGE INTENTIONALLY LEFT BLANK)

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
COMBINING SCHEDULE OF ASSETS, LIABILITIES AND FUND NET ASSETS UNDER RESTRICTED BOND INDENTURES
June 30, 2010
(expressed in thousands)

	1995 REVENUE BONDS	1998 REVENUE BONDS	1999 REVENUE BONDS	2000 REVENUE BONDS	2001 REVENUE BONDS	2002 REVENUE BONDS	2003 REVENUE BONDS	2004 REVENUE BONDS	2005 REVENUE BONDS	2006-1 REVENUE BONDS	2006-2 REVENUE BONDS	2007 REVENUE BONDS	GRAND TOTAL
ASSETS													
Cash and cash equivalents	$ 2,118	$ 1,061	$ 748	$ 837	$ 922	$ 996	$ 1,780	$ 1,607	$ 1,065	$ 558	$ 2,254	$ 34,230	$ 48,176
Investments	-	2,847	5,600	7,245	6,545	162	264	225	571	596	2,323	-	26,378
Educational loans receivable, net	58,733	86,385	87,077	94,831	105,142	93,192	148,802	151,029	173,831	232,193	205,789	65,555	1,502,559
Accrued interest receivable	430	1,247	1,493	1,220	1,342	1,712	2,401	2,825	968	1,278	5,425	2,306	22,647
Inter-fund Activity	39,249	12,391	6,718	8,515	7,938	10,243	13,410	10,558	(37,783)	18,273	7,596	(97,108)	-
Prepaid costs, net	83	756	239	391	422	1,049	7,796	7,234	744	729	3,467	558	23,468
Other assets	222	150	104	105	97	110	182	151	30	184	170	48	1,553
Total assets	$ 100,835	$ 104,837	$ 101,979	$ 113,144	$ 122,408	$ 107,464	$ 174,635	$ 173,629	$ 139,426	$ 253,811	$ 227,024	$ 5,589	$ 1,624,781
LIABILITIES AND FUND NET ASSETS													
LIABILITIES													
Accounts payable and accrued expenses	$ 53	$ 334	$ 316	$ 376	$ 373	$ 535	$ 670	$ 837	$156	$ 267	$ 1,962	$ 1,788	$ 7,667
Accrued interest payable	40	140	129	350	733	303	416	70	24	2,848	99	43	5,195
Due to other funds	9	13	13	15	16	14	23	23	27	36	52	37	278
Contingent arbitrage rebate liability	1,769	562	273	572	41	-	-	-	-	-	2,720	-	5,937
Contingent excess interest liability	-	377	-	-	-	412	-	-	-	-	-		789
Educational loan revenue bonds payable	91,300	100,285	99,725	110,425	119,000	105,800	175,400	178,000	132,742	249,794	229,100	9,320	1,600,891
Total liabilities	93,171	101,711	100,456	111,738	120,163	107,064	176,509	178,930	132,949	252,945	233,933	11,188	1,620,757
FUND NET ASSETS													
Restricted net assets (deficit)	7,664	3,126	1,523	1,406	2,245	400	(1,874)	(5,301)	6,477	866	(6,909)	(5,599)	4,024
Total liabilities and net assets	$ 100,835	$ 104,837	$ 101,979	$ 113,144	$ 122,408	$ 107,464	$ 174,635	$ 173,629	$ 139,426	$ 253,811	$ 227,024	$ 5,589	$ 1,624,781

See Independent Auditor's Report on Accompanying Information.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
COMBINING SCHEDULE OF REVENUE, EXPENSE AND CHANGE IN FUND NET ASSETS UNDER RESTRICTED INDENTURES – RESTRICTED FUNDS
Year Ended June 30, 2010
(expressed in thousands)

	1995 REVENUE BONDS	1998 REVENUE BONDS	1999 REVENUE BONDS	2000 REVENUE BONDS	2001 REVENUE BONDS	2002 REVENUE BONDS	2003 REVENUE BONDS	2004 REVENUE BONDS	2005 REVENUE BONDS	2006-1 REVENUE BONDS	2006-2 REVENUE BONDS	2007 REVENUE BONDS	GRAND TOTAL
REVENUE													
Interest income on investments and cash equivalents	$ 33	$ 255	$ 225	$ 230	$ 110	$ (1)	$ 54	$ 23	$ (7)	$ 7	$ (21)	$ 43	$ 951
Interest on educational loans	2,431	3,315	3,894	3,720	4,139	3,010	4,854	4,266	5,950	7,474	4,924	1,503	49,480
Income from sale of loans	-	-	-	-	-	-	-	-	-	-	-	1,949	1,949
Gain on bond repurchase	1,784	-	-	22	1,650	-	600	-	-	-	600	-	4,656
	4,248	3,570	4,119	3,972	5,899	3,009	5,508	4,289	5,943	7,481	5,503	3,495	57,036
EXPENSE													
Bond and note interest	516	1,762	1,764	752	1,077	644	1,043	887	681	1,658	1,155	4,933	16,872
Auction agent/broker fees	52	42	47	60	74	65	99	98	-	51	125	-	713
Bond fees	34	36	39	49	46	42	67	64	57	88	84	58	664
Loan fees	649	811	758	1,056	1,162	913	2,166	2,071	1,968	2,551	1,538	543	16,186
Contracted management fees	161	226	228	239	263	239	385	397	180	239	540	48	3,145
Contracted loan servicing fees	583	819	827	876	967	873	1,401	1,436	934	1,245	1,955	171	12,087
	1,995	3,696	3,663	3,032	3,589	2,776	5,161	4,953	3,820	5,832	5,397	5,753	49,667
Excess (deficiency) of revenue over expense before other changes and bond issuance costs	2,253	(126)	456	940	2,310	233	347	(664)	2,123	1,649	106	(2,258)	7,369
Other Revenue (Expense)													
Arbitrage rebate	(612)	(115)	(65)	(108)	(41)	-	-	-	-	-	(1,455)	-	(2,396)
Excess interest rebate	(15)	848	(28)	(7)	(3)	143	(70)	(67)	-	-	(162)	(29)	610
Change in fair value of interest rate swaps	-	77	202	-	171	-	-	-	-	-	-	-	450
Excess of revenue over expense before bond issuance costs	1,626	684	565	825	2,437	376	277	(731)	2,123	1,649	(1,511)	(2,287)	6,033
Excess (deficiency) of revenue over expense	1,626	684	565	825	2,437	376	277	(731)	2,123	1,649	(1,511)	(2,287)	6,033
FUND NET ASSETS (DEFICIT) BEGINNING OF YEAR	$ 6,038	$ 2,442	$ 958	$ 581	$ (192)	$ 24	$ (2,151)	$ (4,570)	$ 4,354	$ (783)	$ (5,398)	$ (3,312)	$ (2,009)
FUND NET ASSETS (DEFICIT), END OF YEAR	$ 7,664	$ 3,126	$ 1,523	$ 1,406	$ 2,245	$ 400	$ (1,874)	$ (5,301)	$ 6,477	$ 866	$ (6,909)	$ (5,599)	$ 4,024

See Independent Auditor’s Report on Accompanying Information.