

**NEW MEXICO EDUCATIONAL
ASSISTANCE FOUNDATION**

FINANCIAL STATEMENTS

JUNE 30, 2005

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

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Independent Auditors' Report

The Board of Directors
New Mexico Educational Assistance Foundation

We have audited the accompanying financial statements of the New Mexico Educational Assistance Foundation (NMEAF) as of and for the years ended June 30, 2005 and 2004. These financial statements are the responsibility of the NMEAF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*. 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, principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NMEAF as of June 30, 2005 and 2004, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 9, 2005 on our consideration of the NMEAF's internal control over financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis is not a 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.

Neff + Ricci LLP

Albuquerque, New Mexico
September 9, 2005

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Management's Discussion and Analysis

Fiscal Year Ended June 30, 2005

Overview

The New Mexico Educational Assistance Foundation (the Foundation or NMEAF) functions as a lender and loan servicer to meet the financial needs of New Mexico students seeking post-secondary education. Funding of student loans is achieved through underwritings of tax-exempt debt securities issued by the Foundation for resale primarily to institutional investors. NMEAF services loans issued by affiliated lenders and purchases the loans in the secondary market as they enter repayment. The Foundation provides the following additional services:

- Perkins loan servicing and coordination of accounts receivable collections on behalf of affiliated colleges and universities throughout the state;
- assessment and collection of late & legal fees on delinquent loan balances;
- collection of defaulted loans for the benefit of the New Mexico Student Loan Guarantee Corporation (the Corporation).

As of June 30, 2005 the Foundation had 162,000 loans outstanding to 59,000 current and former students at a total principal value, net of an allowance of doubtful accounts, of approximately \$569 million.

This Management's Discussion and Analysis is required supplementary information under GASB Statement 34. The narrative will focus on changes in results of operations and financial position from the prior year, with emphasis on the current year. Reasons for these changes and economic factors affecting the Foundation's results will be highlighted.

The format and disclosure requirements for the financial statements now differ significantly from those issued in years prior to the effective date of GASB Statement 34. For example, the balance sheet, referred to as the Statement of Net Assets, requires categorization of assets and liabilities by relative liquidity. The focus of the Statement is on Net Assets (commonly referred to as fund balance), which are categorized as either Invested in Capital Assets, Unrestricted, or Restricted.

The income statement, known under GASB 34 as the Statement of Revenues, Expenses and Changes in Net Assets, is formatted by function. Results of operations are delineated between "government-type activities" and "business-type activities." Furthermore, revenues are classified either as "program" or "general" revenues. Program revenues are those derived from sources other than taxpayers or other governments. Management has determined that essentially all of the Foundation's lines of business constitute business-type activities, and all revenues are considered program revenues. An additional requirement of GASB 34 is segregation of revenues and expenses into operating and non-operating components.

GASB 34 requires the Statement of Cash Flows to be prepared using the direct method. This change primarily affects the operating cash flows section of the Statement. The direct method requires the entity to report receipts and expenditures by type.

The topics discussed in this Management's Discussion and Analysis, per GASB 34 guidelines, are the following:

- A brief discussion of the basic financial statements, including the relationships of the statements to each other, and the significant differences in the information they provide;
- Condensed financial information derived from financial statements comparing the current year to the prior year;
- An analysis of the entity's overall financial position and results of operations to assist users in assessing whether financial position has improved or deteriorated as a result of the year's operations;

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- An analysis of balances and transactions of individual funds;
- An analysis of significant variations between original and final budget amounts and between final budget amounts and actual budget results for the general fund, or its equivalent;
- A description of significant capital asset and long-term debt activity during the year, including a discussion of commitments made for capital expenditures, changes in credit ratings, and debt limitations that may affect the financing of planned facilities or services;
- A description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations.

I. Brief Discussion of Financial Statements

The financial statements presented herein are the following:

- Statement of Net Assets;
- Statement of Revenues, Expenses and Changes in Net Assets;
- Statement of Cash Flows.

The Statement of Net Assets summarizes the Foundation's financial position as of the end of the fiscal year. It describes the various classifications of assets, liabilities and the residual net assets. This Statement is distinguished from the other two in that it provides a snapshot of account balances at a particular point in time, as opposed to an accumulation of activity during the period.

The Statement of Revenues, Expenses and Changes in Net Assets illustrates the Foundation's inflows and outflows of financial resources during the year. The accrual of revenue and expense items during the year will affect the year-end balances on the Statement of Net Assets. The increase or decrease in net assets computed on the Statement of Revenues, Expenses and Changes in Net Assets is added to or subtracted from the beginning net assets on the Statement of Net Assets to yield net assets as of the report date.

The Statement of Cash Flows lists the sources and uses of cash during the year, using the direct method. The Statement itemizes the changes in the balance of cash and equivalents from the beginning of the year to year-end. The inflows and outflows of cash during the year help explain the change in the balances of assets and liabilities on the Statement of Net Assets.

For internal management reporting purposes the Foundation segregates financial reporting into two funds – the Debt Fund and the General Fund. The Debt Fund monitors all activity and net assets relating to the Federal Family Education Loan Program (FFELP) student loans and the outstanding debt issued to fund the loans. The General Fund consists of Foundation operating costs and net assets, primarily financed by an administrative allowance from the Debt Fund and service fees. Presentation of the two funds discretely helps distinguish the primary function of the Foundation – financing guaranteed FFELP loans – from general and administrative operations.

With the implementation of GASB Statement 34, the focus of the financial statements is on the overall entity. Therefore, the two funds, which do not meet the criteria for reporting as separate funds in the accompanying financial statements, are combined for presentation on this report. The financial statements are presented in a single-column format as enterprise fund business-type activities.

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Management's Discussion and Analysis

Fiscal Year Ended June 30, 2005

II. Condensed Financial Information

The Foundation's total assets at June 30, 2005 were \$754 million. Condensed financial information is presented below.

	June 30	
	(\$000's)	
	2005	2004
Capital Assets	\$7,408	\$7,922
Other Assets	746,678	732,799
Total Assets	\$754,086	\$740,721
Long-Term Liabilities	646,060	648,846
Other Liabilities	32,820	21,054
Total Liabilities	678,880	669,900
Net Assets:		
Invested in Capital Assets	7,408	7,922
Restricted	47,876	44,878
Unrestricted	19,922	18,021
Total Net Assets	75,206	70,821
Total Liabilities & Net Assets	\$754,086	\$740,721

	Year Ended June 30	
	(\$000's)	
	2005	2004
Revenues:		
Borrower Interest Income & Fees	\$17,858	\$16,741
Federal Subsidies	23,963	20,943
Investment Interest Income	4,917	4,607
Loan Servicing & Other Revenue	2,626	2,929
	<u>49,364</u>	<u>45,220</u>
Expenses:		
Direct Costs – Federal Family Education Loan Program	36,317	28,854
Overhead Costs – Federal Family Education Loan Program	7,046	7,031
Loan Servicing	370	390
Default Collections	1,246	1,383
	<u>44,979</u>	<u>37,658</u>
Change in Net Assets	<u>\$4,385</u>	<u>\$7,562</u>

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III. Analysis of Overall Financial Position and Results of Operations

Analysis of Financial Position:

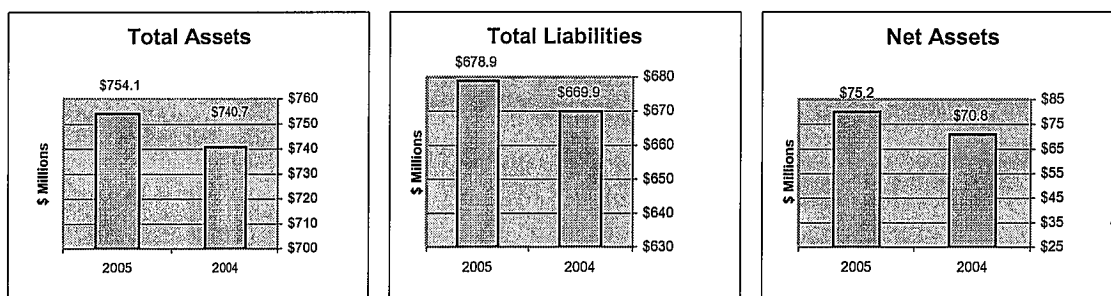
The Foundation's Total Assets at June 30, 2005 were \$754 million, an increase of approximately \$13 million over the balance at June 30, 2004. Significant changes in Total Assets components included:

- An increase of \$46 million in Student Loans Receivable, representing a 9% increase in loan growth. Much of the additional volume for the current year is a result of a new partnership between the University of New Mexico (UNM) and the Foundation, whereby UNM is transitioning most of its student loan volume to the FFELP program and NMEAF.
- A decrease of \$41 million in Investments, the proceeds of which was used to fund the loan growth.
- An increase of \$6 million in Cash & Equivalents. The increase is comprised of amounts due to the bond trustee and disbursement servicing balances pending transfer to school financial offices on behalf of various lenders.
- A \$2 million increase in student loan interest and federal interest subsidies receivable.

Total Liabilities increased by \$9 million to \$679 million, driven by the following primary changes:

- An \$18 million increase in Notes Payable, required for short-term funding of student loans in anticipation of a bond issue;
- An associated \$21 million decrease in Bonds Payable;
- A \$10 million increase in the excess earnings reserve, as the calculated bond yield exceeded the allowable spread;
- A \$2 million increase in accrued interest expense, resulting from increasing rates on the Foundation's variable rate debt.

Net Assets grew by 6% to \$75 million, up from \$71 million a year earlier. Net Assets comprised approximately 10% of Total Assets at June 30, 2005.



Analysis of Results of Operations:

Total Revenues for the Year Ended June 30, 2005 were \$49.4 million, an increase of \$4.2 million from the prior year. The increase is primarily attributable to:

- Higher interest subsidy revenue received from the U.S. Department of Education (the ED) as a result of growth in "in-school, in grace" loan volume;
- Increased late & legal fees revenue, driven primarily by a change in the estimated reserve for uncollectible fees.

Total Expenses for the Year were \$45 million, which was \$7 million unfavorable to the prior year. The primary drivers of the change were:

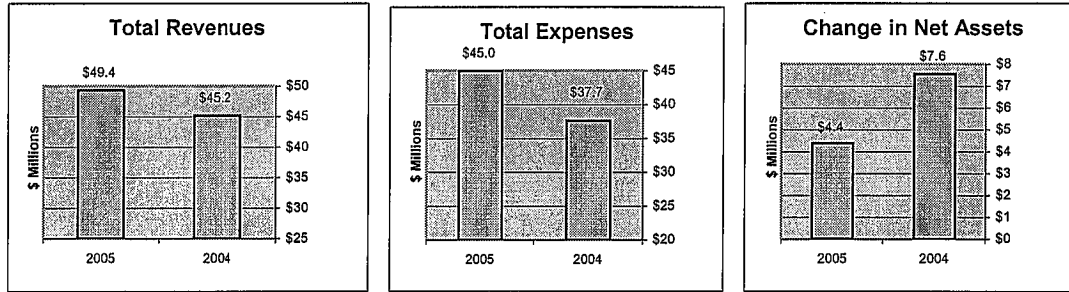
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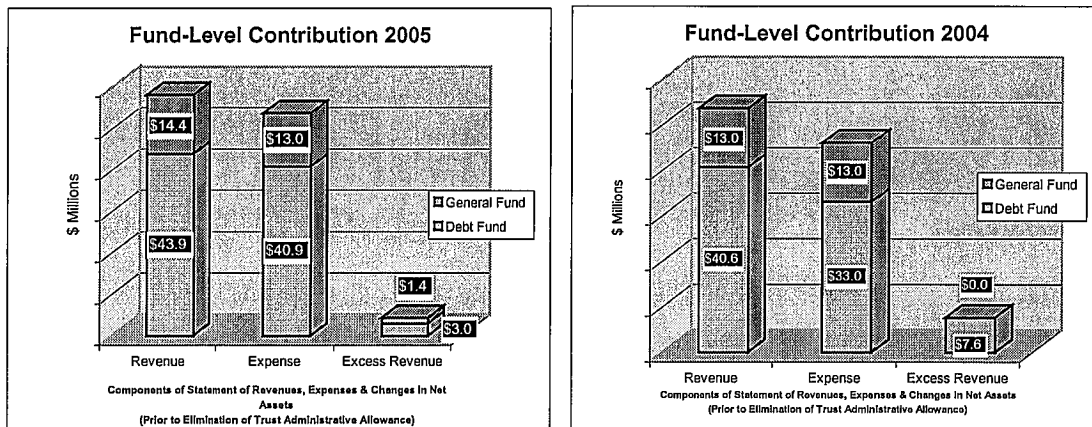
- A \$4.5 million increase in Interest Expense, driven by rising interest costs on outstanding debt;
- A \$1.8 million increase in Excess Earnings and Arbitrage Rebate expenses;
- Increases in depreciation and other general and administrative expenses.

The Change in Net Assets (excess revenue) was \$4.4 million, a decrease of \$3.2 million over the previous year, primarily due to an increase in excess earnings expense which will allow increased borrower benefits.



IV. Analysis of Balances and Transactions of Individual Fund Areas

The following analysis is of the internal funds used by the Foundation. The Debt Fund contributed \$3 million of the \$4.4 million increase in the Foundation's Net Assets. The General Fund realized an excess of revenues over expenses of \$1.4 million. In comparison, for the year ended June 30, 2004 the Debt Fund earned \$7.6 million, while the General Fund just exceeded break-even, earning \$23,000. Although the Debt Fund improved revenue by \$3.3 million over the prior year, total expenses rose by \$7.9 million due to increased interest expense and excess earnings expense. The General Fund's improvement in operating income was driven by increased trust administrative allowance and investment revenue. In addition, management determined that the estimate for uncollectible late & legal fee income was excessive. Adjusting this reserve downward resulted in recording \$0.8 million additional income, bringing the general fund's total excess revenue to \$1.4 million.



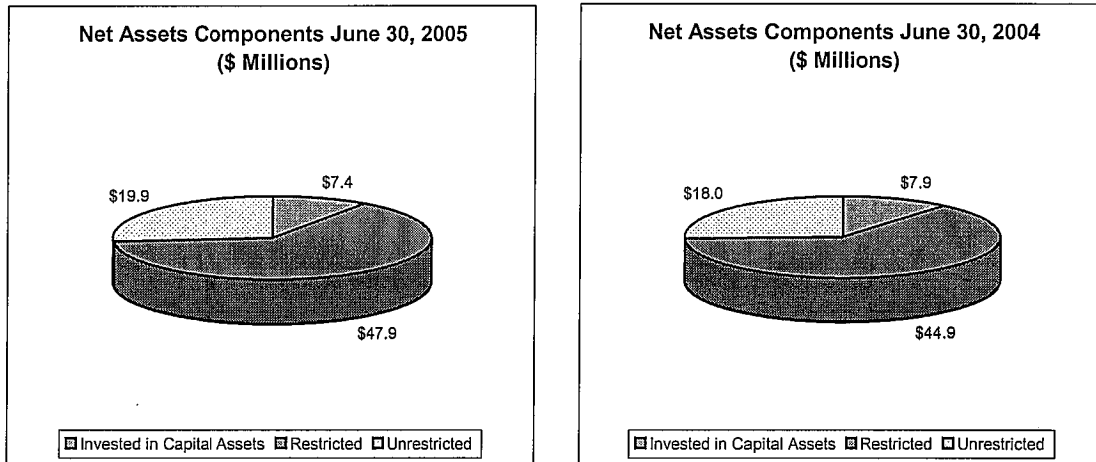
The amount of Net Assets invested in capital assets at June 30, 2005 was \$7.4 million, down from \$7.9 million a year earlier. The decrease resulted from higher depreciation expense and fixed asset retirements in excess of additions. The Restricted Net Assets balance of \$47.9 million, which must be reserved to

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collateralize outstanding bond debt, increased by \$3 million, the amount of Debt Fund net revenue. Unrestricted Net Assets, which are unencumbered, rose by \$1.9 million to \$19.9 million.



The primary inter-fund transactions are periodic payments to the General Fund from the Debt Fund of a "trust administrative allowance." The allowance is a federally prescribed yield on the student loan receivable balance that can be utilized unencumbered by the agency to cover general administrative costs. The allowance comprised 65% of the General Fund's Total Revenues for the year ended June 30, 2005, approximately the same share as in the prior year. In consolidating the two Funds for presentation herein, Trust Administrative Allowance Revenue and Expense were eliminated from the Statement of Revenues, Expenses, and Changes in Net Assets.

V. Analysis of Significant Budgetary Variations

In May 2004 the Foundation's board of directors adopted the fiscal year 2004-2005 operating budget for the Debt Fund, the General Fund and the entity as a whole. This budget was final, although it is not legally binding and therefore is not an integral part of the financial statements. It is the Foundation's policy to freeze the revenue and expense budget as initially approved, then treat new income streams and subsequent approved expenses as non-budgeted items during the year. One exception was made to this policy during the year, as the board approved an addition of \$100,000 to the expense budget to cover anticipated costs to answer findings by the ED Office of Inspector General (OIG).

Actual Total Revenues of \$49.4 million exceeded budget by \$2.5 million, or 5%. This achievement was primarily attributable to greater than budgeted loan program and investment revenues. Total expenses (combined operating and non-operating) of \$45 million were unfavorable to budget by \$5.7 million, or approximately 13%, due in part to excess earnings expense and interest expense that exceeded expectations. The increase in interest expense was attributable to market factors that resulted in higher than expected rates on the Foundation's outstanding floating rate debt. The Change in Net Assets of \$4.4 million was less than the budgeted amount of \$7.7 million, primarily due to excess earnings expense being higher than anticipated.

On a fund-level basis, the General Fund's Change in Net Assets was \$1.4 million vs. budget of \$0.1 million. Excluding the late & legal reserve adjustment, excess revenue was \$0.6 million. Debt Fund excess revenue fell short of the budgeted amount by \$4.6 million, with a Change in Net Assets of \$3 million.

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VI. Description of Significant Capital Asset and Long-Term Debt Activity

Capital Assets

The approved capital budget for the year was \$238,539. Total capital expenditures for the year were \$412,665, or \$174,126 in excess of budget. The major categories of capital expenditures during the year were Building, Office Equipment, Information Technology (IT) hardware, and IT software.

A new headquarters facility for the Foundation and for the New Mexico Student Loan Guarantee Corporation was completed in June 2004. At June 30, 2004 the Foundation recognized all known costs related to construction of the facility. However, during the year ended June 30, 2005 NMEAF incurred \$126,000 in unbudgeted capital expenditures related to the new building. These costs represent the majority of the unfavorable variance in the current year's capital budget.

The information technology infrastructure at NMEAF includes:

- An IBM AS-400 platform for the loan servicing system;
- File servers to run Microsoft Office applications, the general accounting system and other applications;
- Networking equipment;
- PC workstations, printers, and other peripheral devices.

The Foundation expended \$272,000 for hardware and software during the year, which exceeded budget by \$33,000. The unfavorable variance is primarily attributable to the purchase of unbudgeted software purchased in conjunction with the Corporation's guarantee system conversion in April 2005.

Approximately \$15,000 was expended for office equipment (a new copier) that was not included in the annual capital budget.

Long-Term Debt

In July 2004, the Foundation issued \$26.5 million of tax-exempt bonds. All of the proceeds were used to refund existing debt issues in order to preserve federal subsidies on the associated loan assets.

The Moody's and Fitch rating agencies issued Aaa and AAA ratings, respectively, on all Series of the 2004 Senior debt. These ratings are consistent with previous Foundation issues of senior debt.

The Foundation was granted authorization by the State of New Mexico to issue \$90 million in tax-exempt debt in the 2005 calendar year. Management believes this amount will be sufficient to fund student loan and bond refunding initiatives for the coming year.

VII. Discussion of Currently Known Facts, Decisions, or Conditions Expected to Have a Significant Effect on Financial Position

Market interest rates rose substantially during the year, driven in large measure by Federal Reserve Bank increases in the Fed Funds Rate. As a result, the Foundation incurred substantially higher interest expense on its variable rate debt as compared to the prior year.

During the year the University of New Mexico, the state's largest post-secondary educational institution, made the decision to abandon its participation in the federally administered Direct Student Loan program

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Management's Discussion and Analysis

Fiscal Year Ended June 30, 2005

and transition all new student loan volume to the FFELP. In the year ended June 30, 2005 the Foundation realized approximately \$10 million in loan volume from this transition. When this transition is completed in the coming fiscal year, the Foundation will have gained over \$60 million in student loans receivable from the transition.

In April of 2005 the New Mexico State Legislature passed legislation to amend the Foundation's charter in order to permit NMEAF to pursue student lending opportunities at institutions outside the state of New Mexico. The Foundation plans to pursue targeted opportunities in neighboring states in the coming year.

Subsequent to year-end the Foundation was designated an "exceptional performer" by the U.S. Department of Education, based on NMEAF's servicing practices. As a result, for one year following the date of designation the Foundation will receive 100% reimbursement from its guarantee agency on defaulted FFELP loans. The Foundation may apply annually for renewal of this designation if criteria are maintained. During the year ended June 30, 2005 the reimbursement rate for submitted claims was 98%.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Statements of Net Assets

June 30, 2005 and 2004

<u>ASSETS</u>	<u>June 30, 2005</u>	<u>June 30, 2004</u>
<i>Current Assets:</i>		
Cash and Cash Equivalents	\$4,138,723	\$4,711,933
Cash and Cash Equivalents - Restricted	9,911,404	3,514,352
Funds Held In Custody For Others	94,281	76,586
Investments	134,598,706	163,904,105
<i>Receivables:</i>		
Current Portion of Student Loans Receivable, Net	31,903,106	40,183,367
Student Loan Interest Receivable, Net of Allowance of \$21,172 for 2005 and \$22,777 for 2004	5,722,831	5,787,232
Accrued Interest Receivable On Funds Held by Trustee and Investments	717,478	449,380
Student Loan Late and Legal Fees Receivable, Net of Allowance of \$1,316,628 for 2005 and \$2,213,247 for 2004	1,188,849	418,406
Interest Subsidy and Special Allowance Receivable	6,213,005	4,016,766
Other	360,158	451,583
Total Current Assets	<u>194,848,541</u>	<u>223,513,710</u>
<i>Long-Term and Other Assets:</i>		
Student Loans Receivable, Net, Less Current Portion	536,723,071	482,317,500
Investments, Less Current Portion	9,580,816	21,118,866
Debt Issuance Costs and Commitment Fees	5,526,097	5,848,867
Total Long-Term and Other Assets	<u>551,829,984</u>	<u>509,285,233</u>
<i>Capital Assets:</i>		
Furniture & Equipment	3,535,091	3,520,898
Building & Building Improvements	5,482,129	5,441,613
Land	1,011,520	1,011,520
Automobile	107,887	107,887
Less: Accumulated Depreciation	(2,728,707)	(2,160,044)
Total Property, Plant & Equipment	<u>7,407,920</u>	<u>7,921,874</u>
Total Assets	<u>\$754,086,445</u>	<u>\$740,720,817</u>
 <u>LIABILITIES</u>		
<i>Current Liabilities:</i>		
Accounts Payable and Accrued Liabilities	\$3,679,318	\$3,551,399
Bonds Payable, Current Portion	5,530,000	11,545,000
Accrued Interest On Bonds and Note Payable	4,919,357	2,650,455
Arbitrage Payable to Federal Government	0	2,420,619
Funds Held In Custody For Others	28,014	34,355
Note Payable	18,415,000	790,000
Other	248,652	61,959
Total Current Liabilities	<u>32,820,341</u>	<u>21,053,787</u>
<i>Long-Term Liabilities:</i>		
Bonds Payable, Less Current Portion	608,150,000	623,550,000
Reserves For Excess Earnings	31,691,201	21,957,228
Arbitrage Payable to Federal Government, Less Current Portion	6,218,766	3,338,662
Total Long-Term Liabilities	<u>646,059,967</u>	<u>648,845,890</u>
Total Liabilities	<u>678,880,308</u>	<u>669,899,677</u>
 <u>NET ASSETS</u>		
Invested in Capital Assets	7,407,921	7,921,874
Restricted, Bond Indenture	47,876,126	44,878,241
Unrestricted	19,922,090	18,021,025
Total Net Assets	<u>75,206,137</u>	<u>70,821,140</u>
Total Liabilities & Net Assets	<u>\$754,086,445</u>	<u>\$740,720,817</u>

See accompanying notes to financial statements.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Statement of Revenues, Expenses and Changes in Net Assets

Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<i>OPERATING REVENUES:</i>		
Student Loan Interest	\$15,702,875	\$15,659,998
Interest Subsidy and Special Allowance	23,962,730	20,942,924
Interest on Funds Held by Trustee and Investment	4,917,760	4,606,743
Student Loan Late and Legal Fees, Net	2,155,209	1,080,724
Servicing and Administration Agreements:		
New Mexico Student Loan Guarantee Corporation	1,523,948	1,637,151
Servicing Fees	1,101,152	1,243,032
Other	-	49,307
Total Operating Revenues	<u>49,363,674</u>	<u>45,219,879</u>
<i>OPERATING EXPENSES:</i>		
Interest Expense on Bonds and Note Payable	15,502,741	10,998,811
General and Administration:		
Salaries and Employee Benefits	8,425,818	8,485,969
Depreciation and Amortization	1,243,852	1,028,669
Provision for Student Loan Losses	263,463	213,620
Other	7,131,762	6,494,731
Trustee Fees, Amortization of Debt Issuance Costs,		
Commitment Fees and Other Trust Expenses	<u>2,216,795</u>	<u>2,356,962</u>
Total Operating Expenses	<u>34,784,431</u>	<u>29,578,762</u>
 Operating Income	 <u>14,579,243</u>	 <u>15,641,117</u>
<i>NON-OPERATING EXPENSES:</i>		
Arbitrage Rebate	460,273	1,183,050
Excess Earnings	<u>9,733,973</u>	<u>7,178,627</u>
Total Non-Operating Expenses	10,194,246	8,361,677
<i>SPECIAL ITEM:</i>		
Gain On Sale Of Building	-	282,359
Change in Net Assets	<u>\$4,384,997</u>	<u>\$7,561,799</u>
<i>NET ASSETS:</i>		
Beginning	<u>\$70,821,140</u>	<u>\$63,259,341</u>
 Ending	 <u>\$75,206,137</u>	 <u>\$70,821,140</u>

See accompanying notes to financial statements.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Statements of Cash Flows

Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash Flows From Operating Activities:		
Cash Received from Borrowers	\$156,956,722	\$155,611,357
Cash (Disbursed to) Borrowers	(164,426,956)	(139,608,226)
Cash Paid for Incentive Programs	(751,929)	(29,037)
Cash Received from/(Paid to) Others	2,672,850	2,772,294
Cash Paid to Employees	(8,471,405)	(8,622,829)
Cash Paid to Suppliers	(5,839,887)	(6,843,168)
Cash Received From Investments	4,649,661	4,800,278
Cash Paid For Interest On Notes/Bonds	<u>(13,233,839)</u>	<u>(11,066,368)</u>
Net Cash Used by Operating Activities	<u>(28,444,783)</u>	<u>(2,985,699)</u>
Cash Flows From Non-Capital Financing Activities:		
Proceeds on Bonds/Notes	43,691,427	182,686,505
(Payments) on Bonds/Notes	(47,915,000)	(193,020,000)
Trust Expenditures	(2,030,890)	(2,363,886)
Arbitrage/Excess Earnings Expenditures	-	<u>(2,932,195)</u>
Net Cash Used by Non-Capital Financing Activities	<u>(6,254,463)</u>	<u>(15,629,576)</u>
Cash Flows From Capital and Related Financing Activities:		
Purchase of Property & Equipment	(296,324)	(5,892,419)
Proceeds from Sale of Property & Equipment	-	<u>2,306,915</u>
Net Cash Used by Capital and Related Financing Activities	<u>(296,324)</u>	<u>(3,585,504)</u>
Cash Flows From Investing Activities:		
Redemption of Investments	288,310,985	521,059,046
(Purchases) of Investments	(247,467,535)	(503,456,984)
Funds Held in Custody for Others	<u>(24,038)</u>	<u>(42,231)</u>
Net Cash Provided by Investing Activities	<u>40,819,412</u>	<u>17,559,831</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	 5,823,842	 (4,640,948)
Cash and Cash Equivalents, Beginning of Year	<u>8,226,285</u>	<u>12,867,233</u>
Cash and cash Equivalents, End of Year	<u><u>\$14,050,127</u></u>	<u><u>\$8,226,285</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:		
Operating Income	\$14,579,243	\$15,641,117
Adjustments to Reconcile Operating Income to Net Cash Used by Operating Activities:		
Depreciation and Amortization Expense	1,243,852	1,028,670
Trustee Fees, Amortization of Debt Issuance Costs, Commitment Fees and Other Trust Expense	2,216,795	2,356,962
Changes in Assets & Liabilities:		
(Increase) Decrease in Student Loans Receivable, net	(46,125,310)	(24,679,714)
(Increase) Decrease in Student Loan Interest Receivable, Interest Subsidy & Special Allowance Receivable, and Late & Legal Fees Receivable	(2,902,281)	2,532,771
(Increase)Decrease in Investment Income Receivable	(268,098)	193,537
(Increase) Decrease in Other Current Assets (including due from NMSLGC)	91,425	(156,903)
(Increase) Decrease in Debt Issuance Costs & Commitment Fees	322,770	(578,149)
Increase (Decrease) in Accounts Payable & Accrued Liabilities	2,396,821	676,010
Net Cash Used by Operating Activities	<u><u>(\$28,444,783)</u></u>	<u><u>(\$2,985,699)</u></u>
Supplemental Disclosures of Cash Flow Information:		
Interest Collected on FFELP Student Loans	<u>\$15,768,881</u>	<u>\$16,709,137</u>
Interest Subsidy & Special Allowance Collected from U.S. Department of Education	<u>\$21,756,069</u>	<u>\$20,882,071</u>
Arbitrage Rebate Expense Incurred & Liability Accrued	<u>\$459,483</u>	<u>\$1,183,050</u>
Excess Earnings Expense Incurred & Liability Accrued	<u>\$9,733,973</u>	<u>\$7,187,627</u>
Principal Amount of Bonds Refunded or Retired	<u>\$47,915,000</u>	<u>\$183,335,000</u>

See accompanying notes to financial statements.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

(1) Organization

The New Mexico Educational Assistance Foundation (the Foundation or NMEAF) was organized under the laws of the State of New Mexico on July 1, 1981, as a quasi-governmental, not-for-profit organization for the purpose of improving the educational opportunities of the residents of New Mexico and students who attend New Mexico post-secondary educational institutions. NMEAF's primary purpose is to provide a program for making, financing, holding, and purchasing federally insured educational loans. NMEAF also services loans and provides administrative support and other services for in-state educational and lending institutions and administers federal financial aid programs. The New Mexico Student Loan Guarantee Corporation (Corporation), a quasi-governmental, not-for-profit entity operates as a guarantee agency under the Federal Family Education Loan Program (FFELP).

In October of 2003 the Foundation and the Corporation filed a "doing business as" trade name of *New Mexico Student Loans* with the New Mexico State Corporation Commission. As of that date both entities hold themselves out to the public as one organization in order to improve awareness and understanding of their inter-related purpose.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

NMEAF meets the definition of a governmental entity as set forth in the AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*. The financial statements of Foundation are prepared on the basis of an enterprise fund as defined by the Governmental Accounting Standards Board (GASB). Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the entity is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the entity has decided that periodic determination of revenue earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Foundation's government-wide financial statements are designed to be corporate-like in that all business-type activities are consolidated into one column, and consist of a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, and a Statement of Cash Flows. The Foundation carries on no governmental activities. It has neither fiduciary funds nor component units that are fiduciary in nature.

Enterprise funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenue is recorded when earned, and expenses are recorded at the time liabilities are incurred. NMEAF has elected not to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989, which is an alternative followed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*.

Amounts reported as program revenues include:

- Borrower interest income and fees;
- Federal subsidies;
- Investment interest income;
- Loan servicing and other revenue.

Essentially all of the Foundation's revenues are program revenues. Indirect expenses are assigned to the Federal Family Education Loan Program line of business.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

Enterprise funds distinguish operating revenues and expenses from non-operating items. All of the Foundation's revenue streams are considered operating in nature. The principal non-operating expenses are arbitrage rebate and excess earnings expense.

When both restricted and unrestricted net assets are available to cover a designated expense, it is the Foundation's policy to use restricted resources first, and then utilize unrestricted resources as they are needed.

(b) Fund Accounting

The General and Debt Funds (Funds) are separate sets of self-balancing accounts established to account for all transactions pertaining to the general administration, student lending and debt issues of NMEAF. These funds do not meet the criteria for reporting as separate funds in the accompanying financial statements, but are used for internal reporting purposes. Each fund utilizes the accrual basis of accounting whereby revenues are recognized when earned and expenses are recognized when incurred.

All transactions relating to the Funds, which are not presented distinctly in the financial statements, are recorded as described below:

- General Fund: The receipt of revenue and transfers for the payment of expenses for the administration of NMEAF's programs are recorded in the General Fund.
- Debt Fund: Transactions relating to NMEAF's borrowings to finance student loans through the issuance of debt are recorded in the Debt Fund. All revenue and expenses associated with these student loans and all related trust indenture activity are recorded in this fund. The Debt Fund reimburses the General Fund for expenses incurred on its behalf. Various assets and liabilities of each respective debt issue are combined in the accompanying balance sheet although there are various restrictive covenants associated with each issue. Net Assets of the Fund generally are restricted for the repayment of Debt Fund obligations and to satisfy certain reserve requirements specified by the various indentures.

(c) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The allowance for student loan losses, late and legal fees, and arbitrage rebate and excess earnings liabilities are the principal areas involving estimates and judgments. Actual results could differ from those estimates.

(d) Cash and Cash Equivalents, Investments

NMEAF considers cash on hand, in banks, and similar highly liquid instruments to be cash and cash equivalents. Cash equivalents are carried at cost. Cash earmarked for loan disbursement to students and cash collected on student loans but not yet remitted to the trustee are restricted from use for Foundation operations and are shown as Cash and Cash Equivalents – Restricted on the Statement of Net Assets. NMEAF considers all other invested funds to be Investments. Investments include certificates of deposit and are carried at cost, which approximates market value.

Funds held by trustee, which are recorded as Investments on the Statement of Net Assets, consist of the following:

- Money market and deposit funds that are fully secured by a pledge of direct obligations of or guaranteed by the United States of America or certain federal agencies. These investments are carried at cost, which approximates market value.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

- Guaranteed investment contracts that are carried at cost, which approximates market value.

During the year the Foundation began investing in U.S. Treasury bills and notes through the Treasury Direct program. These investments, as well as the guaranteed investment contracts and money markets, are subject to GASB Statement No. 40, *Deposit and Risk Disclosures – An Amendment of GASB Statement No. 3*. As such, they are reported at fair value with maturities and credit ratings by investment type as of June 30, 2005.

(e) *Funds Held in Custody for Others*

NMEAF is the agent for various in-state educational institutions and the private lending community. As an agent, NMEAF holds and disburses funds for the institutions to qualified students.

(f) *Premium on Loans Purchased*

NMEAF defers premiums paid on student loan notes purchased and amortizes them over the estimated life of the loans as an adjustment to the yield of the related loans. Amortization of the premiums is included in interest on student loan notes.

(g) *Interfund Activity*

As a general rule the effect of interfund activity has been eliminated from the financial statements.

(h) *Student Loan Late and Legal Fees Receivable*

NMEAF records late and legal fees to each borrower's account when assessed, in accordance with its litigation policy. However, management believes that a portion of these amounts will not be received from the borrower. As a result, NMEAF records late and legal fees revenue, net of estimated amounts deemed uncollectible.

Recently the Foundation re-examined the Allowance for Student Loan Late & Legal Fees Receivable and determined that the reserve should be reduced. The determination was based on collection activity that exceeded expectations, as well as the resolution of uncertainties concerning assessments. As a result, on June 30, 2005 NMEAF recorded a reduction in the Allowance on the Statement of Net Assets by \$796,110. Accordingly, Student Loan Late & Legal Fees Revenue is increased by this amount.

(i) *Allowance for Student Loan Losses*

NMEAF provides allowances for the following items in the student loan portfolio: student loans receivable (principal), student loan interest and late and legal fees receivable. To the extent NMEAF has properly serviced the student loan portfolio in accordance with the U.S. Department of Education's (ED) due diligence regulations and other requirements, student loan principal and interest receivable was insured by the ED at 98% of the principal and interest balance during the year. As NMEAF was designated an "exceptional performer" by the ED after the close of the year, the reinsurance rate currently is 100%, provided relevant criteria are met.

Allowance considerations are applied to student loan late and legal fees receivable because the only recourse for collection of such receivables is the borrower. Allowances recorded by NMEAF are amounts that, in the judgment of management, are adequate to absorb known and estimated risks in the student loan portfolio. Management considers various factors in providing for these losses, including the amount of loans with due diligence violations, litigation results and estimated successful due diligence cure and collection results on student loans.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

(j) Amortization of Debt Issuance Costs and Commitment Fees

Debt issuance costs and commitment fees are amortized using the bonds outstanding method, which approximates the effective interest rate method, over the contractual repayment term or life of the associated debt (ranging from one to thirty years) or over the commitment period (typically less than one year).

(k) Capital Assets

Capital assets are recorded at cost, net of accumulated depreciation. The capitalization threshold is \$1,000. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Estimated useful lives of the fixed assets are as follows:

Building and building improvements	30 and 10 years, respectively
Building equipment	5 years
Data processing hardware, personal computers	3 years
Data processing hardware, other than personal computers	4 years
Data processing software	3 years
Furniture and fixtures	10 years
Vehicles	3 years

In addition, maintenance and repairs that do not extend the assets' useful lines are charged to expense as incurred.

NMEAF did not receive donations of capital assets during the Year.

(l) Restricted Net Assets

Net Assets held as collateral on outstanding Bonds Payable are classified as Restricted Net Assets.

(m) Revenue Recognition

NMEAF records student loan interest, interest subsidy, and special allowance as revenue when earned.

The ED makes quarterly interest payments to NMEAF while the loan is in an in-school or in-grace status and until the student is required, under the provisions of the Higher Education Act, to begin repayment. Interest becomes due from individual borrowers once the loan goes into repayment status.

The majority of all loans in an in-school or in-grace status are eligible for interest subsidy. This subsidy is equivalent to the annual eligible student loan interest rate multiplied by the daily unpaid loan balance for the period in which the student is in an in-school or in-grace status. The ED also provides a special allowance subsidy to lenders participating in the FFELP.

Special allowances are computed and paid quarterly on the average daily unpaid principal balance of qualifying student loans outstanding based on an annual rate equal to the average bond equivalent rate of 91-day United States Treasury Bills for subsidized loans during the calendar quarter, or for loans first disbursed after January 1, 2000, the 90-day commercial paper rate. NMEAF records interest subsidy and special allowance as revenue when earned. For loans originated after July 1, 1994, a 3% origination fee is charged by NMEAF to student loan borrowers and paid to the ED. Payment of the origination fee to the ED occurs through an offset to the interest subsidy and special allowance payments received from the ED.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

Late and legal fees are recorded as revenue when they have been assessed to each borrower's account in accordance with NMEAF's litigation policy. Service agreement revenue is recorded as earned over the life of the contract, and servicing fees are recorded as earned (see note 9 for additional information).

(n) Income Taxes

NMEAF is a tax-exempt, quasi-governmental organization under Section 501(c)(3) of the Internal Revenue Code (IRC). All of NMEAF's income is from tax-exempt activities. Accordingly, no provision for income taxes has been included in the accompanying financial statements.

(o) Reclassifications

Certain reclassifications have been made to the fiscal year 2004 information to conform to the fiscal year 2005 presentation.

(3) Cash and Cash Equivalents and Investments

NMEAF considers cash deposits in banks, unrestricted money market funds, and cash on hand to be cash and cash equivalents. Other invested funds, including guaranteed investment contracts, U.S. Treasury securities, trustee-held money markets, and certificates of deposit, are classified as investments. GASB Statement No. 40 amends GASB Statement No. 3 to change required disclosures relating to cash and equivalents and investments. While this new Statement eliminates the custodial credit risk categorization requirements, additional disclosures are now required, including estimation of fair value as of the report date, and exposure of each investment to credit risk, if any, as measured by nationally recognized statistical rating organizations. For purposes of presentation on this footnote, all cash and cash equivalents and investments are displayed in a single schedule.

The Foundation's investment policy specifies that all investments must comply with New Mexico State Statute 21-21A-17. Generally, this Statute permits investment of funds in the following types of instruments:

- Direct obligations of the United States or its agencies (GNMA, FNMA, FHLB, etc.),
- Certificates of deposit fully collateralized by the above;
- If proceeds from a bond issue, in securities specified under the trust indenture.

Investments listed below as guaranteed investment contracts and money market funds – bond fund are carried at cost, which approximates market value due to the short-term nature of the accounts. The credit ratings of these investments are obtained from Moody's Investors Service. They are restricted to the extent required by the bond indentures. Money market funds have no stated maturities.

Certificates of deposit (CDs) and demand deposits are fully collateralized by U.S. Agency securities. CDs and cash deposits have no established credit rating. Money market funds – general fund are held with a publicly held bank holding company. Although the money market has no explicit credit rating, the bank has a Standard & Poors rating of A1.

U.S. Treasury notes and bills are held on account with the Treasury Direct program. Credit quality disclosure is not required for these securities.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

Cash and equivalents and investments balances, June 30, 2005:

<u>Investment</u>	<u>Maturity</u>	<u>Rating</u>	<u>Fair Value</u>
Guaranteed Investment Contracts:			
1994 Series II - Societe Generale	12/1/2009	AAA	\$3,800,363
1995 Series IV - Societe Generale	3/1/2010	AAA	2,224,130
1995 Series A Float - Westdeutsche	11/1/2010	AAA	3,628,883
1995 Series A Reserve - Trinity	11/1/2010	AAA	398,000
1995 Series A (ALF) - FGIC	8/1/2008	AAA	152,225
1996 Series A & B - Bayerische	11/1/2025	AAA	33,898,468
1998 Series A, B & C - Bayerische	11/1/2028	AAA	20,532,982
1999 Series A & B - Societe Generale	11/1/2028	AAA	4,351,498
2000 Series A & B - Trinity	5/1/2030	AAA	3,721,269
2001 Series A & B - Trinity	9/1/2031	AAA	6,005,671
2002 Series A - Trinity	11/1/2032	AAA	9,796,232
2003 Series A - Trinity	9/1/2033	AAA	4,846,704
2004 Series A - Trinity	4/1/2034	AAA	3,953,818
Money Market Funds - Bond Fund	N/A	AAA	18,039,143
Money Market Funds - General Fund	N/A	N/A	3,634,112
Certificate of Deposit - Bank of Albuquerque	June, 2007	N/A	8,833,141
U.S. Treasury Notes	May, 2007	N/A	741,588
U.S. Treasury Bills	November, 2005	N/A	747,675
Certificate of Deposit - Recycled Capital	April, 2006	N/A	18,507,730
Demand Deposits and Cash on Hand	N/A	N/A	10,416,015
Total			<u>\$158,229,649</u>

Cash and equivalents and investments balances, June 30, 2004:

<u>Investment</u>	<u>Maturity</u>	<u>Rating</u>	<u>Fair Value</u>
Guaranteed Investment Contracts:			
1994 Series II - Societe Generale	12/1/2009	AAA	\$3,342,754
1994 Series Three - Bayerische	12/1/2004	AAA	1,374,424
1995 Series IV - Societe Generale	3/1/2010	AAA	3,798,137
1995 Series A Float - Westdeutsche	11/1/2010	AAA	5,326,947
1995 Series A Reserve - Trinity	11/1/2010	AAA	865,500
1995 Series A (ALF) - FGIC	8/1/2008	AAA	234,796
1996 Series A & B - Bayerische	11/1/2025	AAA	21,399,259
1998 Series A, B & C - Bayerische	11/1/2028	AAA	10,084,523
1999 Series A & B - Societe Generale	11/1/2028	AAA	5,999,998
2000 Series A & B - Trinity	5/1/2030	AAA	15,109,461
2001 Series A & B - Trinity	9/1/2031	AAA	7,276,828
2002 Series A - Trinity	11/1/2032	AAA	10,000,000
2003 Series A - Trinity	9/1/2033	AAA	11,763,681
2004 Series A - Trinity	4/1/2034	AAA	10,915,418
Money Market Funds - Bond Fund	N/A	AAA	66,111,961
Money Market Funds - General Fund	N/A	N/A	2,837,015
Certificate of Deposit - Bank of Albuquerque	June, 2007	N/A	8,448,102
Certificate of Deposit - Bank of the West	June, 2005	N/A	2,169,440
Certificate of Deposit - Recycled Capital	April, 2006	N/A	801,742
Demand Deposits and Cash on Hand	N/A	N/A	5,389,270
Total			<u>\$193,249,256</u>

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

(4) Student Loans Receivable

Student loans receivable by bond issue and status, June 30, 2005:

Bond Issue	Status		Total
	Student	Repayment	
General Fund	\$ -	\$ (712,127)	\$ (712,127)
1992 Series One A & B	-	-	-
1993 Series Two A & B	-	(2,400)	(2,400)
1994 Series Two A, B & C	141,175	6,196,185	6,337,360
1994 Series Three A & B	-	(3,065)	(3,065)
1995 Series Four A1, A2, & B	160,661	8,676,276	8,836,937
1995 Series A	170,907	10,005,563	10,176,470
1995 Series ALF	-	195,246	195,246
1996 Series A	10,782,444	16,520,644	27,303,088
1996 Series B	8,361,675	11,820,434	20,182,109
1998 Series A, B & C	6,660,138	21,277,334	27,937,472
1999 Series A, B & C	2,993,186	37,129,119	40,122,305
2000 Series A, B, & C	46,347,814	22,680,522	69,028,336
2001 Series A, B, C, & D	39,276,536	63,337,123	102,613,659
2002 Series A, B, C, & LINK	16,756,451	49,190,295	65,946,746
2003 Series A, B, C, & D	20,652,348	65,281,139	85,933,487
2004 Series C	16,457,345	88,657,822	105,115,167
Total	\$168,760,680	\$400,250,110	\$569,010,790
Less allowance for student loan principal	114,071	270,542	384,613
Total	<u>\$ 168,646,609</u>	<u>\$ 399,979,568</u>	<u>\$ 568,626,177</u>

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

Student Loans Receivable by bond issue and status, June 30, 2004:

Bond Issue	Status		Total
	Student	Repayment	
General Fund	\$ -	\$ 631,082	\$ 631,082
1992 Series One A & B	38,553	1,072,762	1,111,315
1993 Series Two A & B	41,135	417,222	458,357
1994 Series Two A, B & C	188,915	9,664,445	9,853,360
1994 Series Three A & B	21,171	1,248,658	1,269,829
1995 Series Four A1, A2, & B	224,259	12,652,234	12,876,493
1995 Series A	338,336	14,019,028	14,357,364
1995 Series ALF	-	244,150	244,150
1996 Series A	7,338,524	26,127,054	33,465,578
1996 Series B	5,241,900	20,938,907	26,180,807
1998 Series A, B & C	13,946,513	19,859,278	33,805,791
1999 Series A, B & C	4,741,288	32,744,545	37,485,833
2000 Series A, B, & C	6,897,628	13,866,633	20,764,261
2001 Series A, B, C, & D	56,638,688	53,833,907	110,472,595
2002 Series A, B, C, & LINK	7,015,522	57,569,714	64,585,236
2003 Series A, B, C, & D	22,832,234	59,466,289	82,298,523
2004 Series A-1/A-2	13,159,413	59,844,867	73,004,280
Total	\$138,664,079	\$384,200,775	\$522,864,854
Less allowance for student loan principal	96,530	267,457	363,987
Total	\$138,567,549	\$383,933,318	\$522,500,867

Student loans receivable had variable and fixed interest rates, ranging from 2.77% to 9% at June 30, 2005, and from 2.82% to 9% at June 30, 2004.

Student loans are classified as being in either "in-school/in-grace" or "repayment" status. In-school/in-grace status represents the period from the date the loan is made until a student is out of school for a grace period, plus any authorized deferment periods, at which time the repayment status commences. Substantially all student loans receivable are loans provided under the FFELP and are guaranteed.

Management estimates that approximately \$31.9 million, or about 6% of the outstanding balance of student loans receivable is due within one year. Generally, Foundation loans are structured with a ten-year repayment period.

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

(5) Capital Assets

Capital asset activity, year ended June 30, 2005:

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	<u>Balance</u> <u>June 30, 2005</u>
Business-Type Activities:					
Capital Assets, Not Being Depreciated					
Land	\$1,011,520	-	-	-	\$1,011,520
Total Capital Assets, Not Being Depreciated	1,011,520	-	-	-	1,011,520
Capital Assets, Being Depreciated					
Building, Building Equipment & Improvements	5,620,485	54,964	(38,622)	-	5,636,827
Furniture and Fixtures	644,924	-	(13,566)	-	631,358
Data Processing Hardware	689,336	160,171	(164,483)	30,000	715,024
Data Processing Software	2,007,766	111,863	(55,618)	(30,000)	2,034,011
Vehicles	107,887	-	-	-	107,887
Total Capital Assets, Being Depreciated	9,070,398	326,998	(272,289)	-	9,125,107
Less Accumulated Depreciation For:					
Building, Building Equipment & Improvements	(179,307)	(210,060)	38,624	-	(350,743)
Furniture and Fixtures	(40,931)	(63,106)	12,613	-	(91,424)
Data Processing Hardware	(418,285)	(153,293)	134,760	(14,000)	(450,818)
Data Processing Software	(1,444,856)	(367,278)	55,616	14,000	(1,742,518)
Vehicles	(76,665)	(16,539)	-	-	(93,204)
Total Accumulated Depreciation	(2,160,044)	(810,276)	241,613	-	(2,728,707)
Total Capital Assets, Being Depreciated, Net	6,910,354	(483,278)	(30,676)	-	6,396,400
Business-Type Activities Capital Assets, Net	\$7,921,874	(\$483,278)	(\$30,676)	-	\$7,407,920

NEW MEXICO EDUCATIONAL ASSISTANCE FOUNDATION

Notes to Financial Statements

June 30, 2005

Capital asset activity, year ended June 30, 2004:

	<u>Balance</u>				<u>Balance</u>
	<u>July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	<u>June 30, 2004</u>
Business-Type Activities:					
Capital Assets, Not Being Depreciated					
Land	\$1,497,685	-	(\$486,165)	-	\$1,011,520
Building Project in Progress	<u>214,634</u>	<u>5,758,765</u>	-	<u>(5,973,399)</u>	-
Total Capital Assets, Not Being Depreciated	1,712,319	5,758,765	(486,165)	(5,973,399)	1,011,520
Capital Assets, Being Depreciated					
Building and Building Improvements	2,925,170	5,383,217	(3,060,710)	372,808	5,620,485
Furniture and Fixtures	336,622	598,270	(289,968)	-	644,924
Data Processing Hardware - Information Systems	1,433,798	-	-	(1,433,798)	-
Data Processing Hardware - Emerging Technologies	562,199	72,685	(927,972)	982,424	689,336
Data Processing Software - Information Systems	3,132,294	-	-	(3,132,294)	-
Data Processing Software - Emerging Technologies	394,662	53,130	(1,650,887)	3,210,860	2,007,766
Vehicles	<u>86,420</u>	<u>21,467</u>	-	-	<u>107,887</u>
Total Capital Assets, Being Depreciated	8,871,165	6,128,769	(5,929,537)	-	9,070,398
Less Accumulated Depreciation For:					
Building and Building Improvements	(1,305,345)	(92,257)	1,546,280	(327,985)	(179,307)
Furniture and Fixtures	(297,676)	(11,960)	268,705	-	(40,931)
Data Processing Hardware - Information Systems	(1,263,058)	-	-	1,263,058	-
Data Processing Hardware - Emerging Technologies	(249,869)	(172,611)	924,816	(920,621)	(418,285)
Data Processing Software - Information Systems	(2,542,931)	-	-	2,542,931	-
Data Processing Software - Emerging Technologies	(159,330)	(357,770)	1,629,627	(2,557,383)	(1,444,856)
Vehicles	<u>(66,089)</u>	<u>(10,576)</u>	-	-	<u>(76,665)</u>
Total Accumulated Depreciation	<u>(5,884,298)</u>	<u>(645,174)</u>	<u>4,369,428</u>	-	<u>(2,160,044)</u>
Total Capital Assets, Being Depreciated, Net	2,986,868	5,483,595	(1,560,109)	-	6,910,354
Business-Type Activities Capital Assets, Net	<u>\$4,699,186</u>	<u>\$11,242,361</u>	<u>(\$2,046,274)</u>	<u>(\$5,973,399)</u>	<u>\$7,921,874</u>

Depreciation expense, segregated by function, was as follows:

	<u>Year Ended</u>	<u>Year Ended</u>
	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Building and Building Improvements	\$210,063	\$92,257
Furniture and Fixtures	63,106	11,960
Data Processing Hardware	153,293	172,611
Data Processing Software	367,278	357,770
Vehicles	<u>16,539</u>	<u>10,576</u>
Total Depreciation Expense	<u>\$810,279</u>	<u>\$645,174</u>

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(6) Long-term Liabilities

Long-term liabilities business-type activity for the year ended June 30, 2005:

	<u>Balance 06/30/2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Due Within One Year</u>	<u>Balance 06/30/2005</u>
Bonds Payable	\$635,095,000	\$26,500,000	(\$47,915,000)	(\$5,530,000)	\$608,150,000
Reserves for Excess Earnings	21,957,228	9,733,973	-	-	31,691,201
Arbitrage Rebate Payable	<u>5,759,282</u>	<u>459,484</u>	-	-	<u>6,218,766</u>
Total Long-Term Liabilities	<u>\$662,811,510</u>	<u>\$36,693,457</u>	<u>(\$47,915,000)</u>	<u>(\$5,530,000)</u>	<u>\$646,059,967</u>

Long-term liabilities business-type activity for the year ended June 30, 2004:

	<u>*Balance 06/30/2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Due Within One Year</u>	<u>Balance 06/30/2004</u>
Bonds Payable	\$645,590,000	\$172,840,000	(\$183,335,000)	(\$11,545,000)	\$623,550,000
Reserves for Excess Earnings	15,896,688	6,060,540	-	-	21,957,228
Arbitrage Rebate Payable	<u>6,391,128</u>	<u>1,182,261</u>	<u>(1,814,108)</u>	<u>(2,420,619)</u>	<u>3,338,662</u>
Total Long-Term Liabilities	<u>\$667,877,816</u>	<u>\$180,082,801</u>	<u>(\$185,149,108)</u>	<u>(\$13,965,619)</u>	<u>\$648,845,890</u>

*Beginning balance includes current portion of long-term liabilities.

Student Loan Revenue bonds activity for the year ended June 30, 2005, and balances by bond issue as of June 30, 2005:

<u>Bond Issue</u>	<u>Interest Rate Range</u>	<u>Maturity Range</u>	<u>Bonds Outstanding 06/30/2004</u>	<u>Issued / (Retired) FY 2005</u>	<u>Bonds Outstanding 06/30/2005</u>
1994 Series II	5.30 - 6.00%	12/1/2005-2008	5,385,000	(3,925,000)	1,460,000
1994 Series Three			875,000	(875,000)	-
1995 Series IV	6.70 - 7.45%	3/1/2006-2010	15,695,000	(4,535,000)	11,160,000
1995 Series A	Variable - 6.60%	11/1/2005-2010	14,710,000	(6,750,000)	7,960,000
1995 Series A (ALF)	5.50 - 5.85%	8/1/2005-2008	145,000	(100,000)	45,000
1996 Series A	Variable - 6.75%	11/1/2008-2025	43,600,000	(740,000)	42,860,000
1996 Series B	Variable	11/01/2025	30,700,000	(700,000)	30,000,000
1998 Series A & B	Variable	11/1/2010-2028	33,500,000	-	33,500,000
1998 Series C	5.50%	11/01/2010	2,000,000	-	2,000,000
1999 Series A & B	Variable	5/1/2012-11/1/2028	48,900,000	(300,000)	48,600,000
2000 Series A & B	Variable	5/1/2012-2030	66,400,000	(4,800,000)	61,600,000
2001 Series A & B	Variable - 5.90%	9/1/2009-2031	123,145,000	(14,200,000)	108,945,000
2002 Series A	Variable	11/01/2032	77,200,000	(7,200,000)	70,000,000
2003 Series A	Variable - 1.55%	12/15/2005-9/1/2033	89,590,000	(3,790,000)	85,800,000
2004 Series A	Variable	4/1/2034	<u>83,250,000</u>	<u>26,500,000</u>	<u>109,750,000</u>
			<u>\$635,095,000</u>	<u>(\$21,415,000)</u>	<u>\$613,680,000</u>

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Student Loan Revenue bonds activity for the year ended June 30, 2004, and balances by bond issue as of June 30, 2004:

<u>Bond Issue</u>	<u>Interest Rate Range</u>	<u>Maturity Range</u>	<u>Bonds Outstanding 06/30/2003</u>	<u>Issued / (Retired) FY 2004</u>	<u>Bonds Outstanding 06/30/2004</u>
1994 Series II	5.20 - 6.00%	12/1/2004-2008	13,390,000	(8,005,000)	5,385,000
1994 Series Three	6.00 - 6.30%	12/1/2004	4,485,000	(3,610,000)	875,000
1995 Series IV	6.60 - 7.45%	3/1/2005-2010	23,760,000	(8,065,000)	15,695,000
1995 Series A	Variable - 6.60%	11/1/2004-2010	27,070,000	(12,360,000)	14,710,000
1995 Series A (ALF)	5.40 - 5.85%	8/1/2004-2008	240,000	(95,000)	145,000
1996 Series A	Variable - 6.75%	11/1/2008-2025	43,600,000	-	43,600,000
1996 Series B	Variable	11/1/2004-2025	44,700,000	(14,000,000)	30,700,000
1998 Series A & B	Variable	11/1/2010-2028	89,400,000	(55,900,000)	33,500,000
1998 Series C	5.50%	11/1/2010	2,000,000	-	2,000,000
1999 Series A & B	Variable	5/1/2005-11/1/2028	69,200,000	(20,300,000)	48,900,000
2000 Series A & B	Variable	5/1/2010-2030	102,650,000	(36,250,000)	66,400,000
2001 Series A & B	Variable - 5.90%	3/1/2009-9/1/2031	135,695,000	(12,550,000)	123,145,000
2002 Series A	Variable	5/1/2005-11/1/2032	89,400,000	(12,200,000)	77,200,000
2003 Series A	Variable - 1.55%	6/15/2005-9/1/2033	-	89,590,000	89,590,000
2004 Series A	Variable	4/1/2034	-	83,250,000	83,250,000
			<u>\$645,590,000</u>	<u>(\$10,495,000)</u>	<u>\$635,095,000</u>

As of June 30, 2005, interest rates for the variable bond issues are as follows: 1995 Series A – 3.10%; 1996 Series A – 2.92%; 1996 Series B – 2.65%; 1998 Series A and B – 2.70% to 2.94%; 1999 Series A and B – 2.65% to 3.15%; 2000 Series A and B – 2.60% to 3.23%; 2001 Series A – 2.75% to 2.90%; 2002 Series A – 2.90% to 3.10%; 2003 Series A – 2.65% to 2.70%; and 2004 Series A – 2.75% to 3.00%.

Interest is payable on a semi-annual basis whereas, depending on the bond, principal is payable annually or at specified times during the bond maturity period. All bond issues are tax-exempt and are secured as described in the applicable bond resolutions. Related purchased and financed student loans and investments secure the bonds.

Principal maturity and interest requirements on bonds payable were as follows:

<u>June 30, 2005</u>			<u>June 30, 2004</u>		
<u>Year</u>	<u>Bond Principal</u>	<u>Bond Interest</u>	<u>Year</u>	<u>Bond Principal</u>	<u>Bond Interest</u>
2006	\$5,530,000	\$19,194,056	2005	\$11,545,000	\$11,905,063
2007	3,425,000	18,906,672	2006	6,165,000	11,446,366
2008	2,425,000	18,753,147	2007	4,170,000	11,119,181
2009	7,555,000	18,311,574	2008	3,050,000	10,905,529
2010	34,980,000	16,700,934	2009	8,245,000	10,447,775
2011 - 2015	65,225,000	74,707,288	2010 - 2014	132,515,000	38,319,730
2016 - 2020	-	72,287,287	2015 - 2019	-	35,339,038
2021 - 2025	-	72,247,721	2020 - 2024	-	35,358,390
2026 - 2030	181,825,000	58,810,075	2025 - 2029	131,240,000	29,816,239
2031 - 2035	312,715,000	24,837,323	2030 - 2034	338,165,000	15,488,500
	<u>\$613,680,000</u>	<u>\$394,756,077</u>		<u>\$635,095,000</u>	<u>\$210,145,811</u>

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Bond interest for the variable bond issues was calculated using the auction rates as of June 30, 2005 (see bonds activity schedules for lists of variable rates at June 30, 2005).

In accordance with the provisions of the IRC and related regulations, retainable earnings from non-purpose investments related to NMEAF's tax-exempt bond issues, generally, are limited to the bond yield of the related bond issue. The bond indentures require NMEAF to make annual arbitrage calculations to determine if investments of excess bond proceeds are earning rates of interest in excess of the bond yield. Such amounts, if any, are required to be set aside in arbitrage rebate accounts for each bond issue. The balance in the arbitrage rebate accounts may increase or decrease annually (but not below zero) based on interest rates earned on the investments provided by the bond financing. At the end of each five-year period over the life of the bonds, NMEAF is required to remit any positive arbitrage rebate liability amount to the federal government. Based on the most recent calculations as of June 1, 2005, there are arbitrage rebate liabilities in an aggregate amount of \$6,218,766 related to estimated future payments of excess investment income for the 1995 Series A, 1996 Series A and B, 1998, 1999, 2000, 2002 and 2003 bond issues.

Similarly, student loan income on all tax-exempt bond issues that may be retained by NMEAF in order to fund operations is limited to the bond yield plus an allowable spread, ranging from 1.50% to 2.00%. The excess earnings liability is computed on an annual basis. Excess earnings calculations are completed based on the respective bond year, which may differ from NMEAF's fiscal year end. The excess earnings reserve can be used over time to forgive principal and/or interest on financed student loans or on other programs that would effectively reduce NMEAF's yield. Amounts not used in this manner are required to be paid to the federal government at the end of each ten-year period and at final maturity of the related bond issues.

Based on the most recent calculations as of June 1, 2004 and an estimated increase in liability for fiscal year 2005, there are excess earnings reserves in an aggregate amount of \$31,691,201 related to estimated future payments of excess loan income for the 1994 Series II, 1995 Series A, 1996 Series A and B, 1998, 1999, 2002, 2003 and 2004 bond issues.

In July 2004 the Foundation issued \$26.5million of tax-exempt bonds. All of the proceeds were used to refund existing debt issues in order to preserve federal subsidies on the associated loan assets. The present value of the difference in cash flow requirements for 2005 vs. 2004 for refunded bonds was \$78.2 million. The refunding by outstanding bond Series was as follows:

2004A-3 Bonds (issued July 2004)
Issue Size \$26,500,000
Refunded Bonds \$26,500,000

<u>Refunded Issue</u>	<u>Refund Amount</u>
Series 1999	300,000
Series 2000	4,800,000
Series 2001	14,200,000
Series 2002	7,200,000
	<u>\$26,500,000</u>

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Refunding activity for the year ended June 30, 2004:

2003 Bonds (issued October 2003)	2004 Bonds (issued April 2004)
Issue Size \$89,590,000	Issue Size \$83,250,000
Refunded Bonds \$89,560,000	Refunded Bonds \$83,225,000

<u>Refunded Issue</u>	<u>Refund Amount</u>	<u>Refunded Issue</u>	<u>Refund Amount</u>
1994 Series Three	\$3,590,000	1994 Series Three	\$20,000
1994 Series II	6,910,000	1994 Series II	1,095,000
1995 Series IV	210,000	1995 Series IV	8,095,000
1995 Series A	8,835,000	1995 Series A	2,765,000
1995 Series A (ALF)	65,000	1996 Series B	9,600,000
1996 Series B	4,400,000	Series 1998	21,700,000
Series 1998	24,200,000	Series 1999	4,500,000
Series 1999	15,800,000	Series 2000	23,250,000
Series 2000	13,000,000	Series 2002	12,200,000
Series 2001	12,550,000		<u>\$83,225,000</u>
	<u>\$89,560,000</u>		

(7) **Note Payable**

Summary of changes in short-term debt for the year ended June 30, 2005:

<u>Short-Term Note (Due Within One Year)</u>	<u>Balance 06/30/2004</u>	<u>Issuances</u>	<u>Retirements</u>	<u>Balance 06/30/2005</u>
Notes Payable	<u>\$790,000</u>	<u>\$17,625,000</u>	<u>\$0</u>	<u>\$18,415,000</u>

Summary of changes in short-term debt for the year ended June 30, 2004:

<u>Short-Term Note (Due Within One Year)</u>	<u>Balance 06/30/2003</u>	<u>Issuances</u>	<u>Retirements</u>	<u>Balance 06/30/2004</u>
Notes Payable	<u>\$245,000</u>	<u>\$10,230,000</u>	<u>(\$9,685,000)</u>	<u>\$790,000</u>

NMEAF has a letter of credit in the amount of \$62 million with Bank of America (the Bank) with a maturity date of April 1, 2006. At June 30, 2004, as required by the note, NMEAF had on deposit \$790,000 in the form of short-term investments as collateral at the Bank. During 2005, NMEAF made draws against its short-term note payable with the Bank. As of June 30, 2005, NMEAF has on deposit \$18,415,000 as collateral for the outstanding note balance. The difference in the interest rate earned on the short-term investment and paid on the short-term note payable was .25%.

State and federal statutes limit NMEAF's bond capacity (or ability to issue tax-exempt bonds). Management entered into this short-term note and investment transaction to capture bond capacity for subsequent tax-exempt bond issues. NMEAF periodically enters into similar short-term investment and note payable agreements to preserve bond capacity.

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(8) Contractual Arrangements

NMEAF has certain contractual arrangements as follows:

(a) *The New Mexico Student Loan Guarantee Corporation*

The Corporation's primary purpose is to guarantee, on behalf of the ED, the repayment of eligible student loans made by participating lenders to residents of New Mexico and students who attend New Mexico educational and vocational institutions under the FFELP. Under terms of a service agreement, NMEAF provides office space and administers and performs certain duties and functions for the Corporation, subject to the direction of the Corporation's officers and board of directors. These duties and functions were provided by NMEAF for a board-approved fixed fee of \$1,523,948 and \$1,637,151 based upon estimated costs for the Corporation's years ended September 30, 2005 and 2004, respectively.

On April 1, 2005 twelve Foundation employees whose salary and benefits costs were reimbursed to the Foundation from the Corporation under this arrangement became employees of the Corporation, per ED mandate. From that point forward, all salaries and benefits for these employees are paid directly by the NMSLGC entity. As such, effective April 1, 2005 the service fee income paid to the Foundation by the Corporation was decreased accordingly.

(b) *Servicing Fees*

NMEAF has agreements whereby it provides various legal, servicing, collections and financial aid support services to other in-state education-related institutions, the private lending community and the New Mexico Student Loan Guarantee Corporation. The education-related institutions include the University of New Mexico, New Mexico State University, Eastern New Mexico University, New Mexico Highlands University, New Mexico Military Institute, Northern New Mexico Community College, New Mexico Institute of Mining and Technology, San Juan College, St. Johns College, Albuquerque Technical Vocational Institute, and Luna Community College. NMEAF also provides collection activity through contract sources for the New Mexico Commission on Higher Education.

On April 1, 2005 the Foundation began acting as the disbursing agent for most lenders who utilize the New Mexico Student Loan Guarantee Corporation as their loan guarantor. Commencement of this service was in concert with the Corporation's conversion to a new loan guarantee servicing system. Under the disbursement agreements NMEAF is required to transfer funds received from lender accounts to educational institutions on behalf of the lenders and return cancelled loan amounts to the lender accounts. Fees derived by NMEAF for this service are not material.

Fees earned under agreements to service various student receivables, which are assets or responsibilities of the education-related institutions, were approximately \$1.0 million and \$1.1 million for the years ended June 30, 2005 and 2004, respectively. Fees earned under other agreements with the private lending community were approximately \$142,000 and \$127,000 for the years ended June 30, 2005 and 2004, respectively.

(9) Defined Contribution Plan

NMEAF maintains a Defined Contribution Retirement Plan (the Plan). For employees hired prior to January 1, 2004, participation in the Plan is available to employees regularly scheduled to work 1,000 hours or more in a computation period. For employees hired on or after January 1, 2004, participation is available to employees scheduled to work 2,080 hours or more in a computation period. Eligibility begins on the first day of the month following the completion of 30 days of employment. Each eligible participant is required to contribute a minimum of 3.5% of his or her pay to the Plan. NMEAF contributes 7% of the participant's compensation when the participant contributes the minimum percentage to the Plan. Vesting in NMEAF contributions occurs on a step schedule as follows: 1 year 0%, 2 years 25%, 3 years 50%, 4 years 75%, 5 years 100%. A participant receives a year of service for vesting purposes if he/she completes the scheduled work hours in an anniversary

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year and he/she is employed on the last day of the anniversary year. If the participant terminates before the date of full vesting, the non-vested amount of the participant's account is forfeited and used by NMEAF to reduce its Plan contributions for the next year. NMEAF may terminate this Plan at any time, and all participant accounts would become 100% vested. NMEAF does not intend to terminate the Plan at this time. For the years ended June 30, 2005 and 2004, NMEAF's contribution was approximately \$398,000 and \$429,000, respectively.

(10) Self-funded Employee Health and Dental Insurance Plans

On January 1, 2005 the Foundation abandoned its traditional employee medical and dental insurance coverages in favor of a self-funded arrangement managed by a third party administrator. The goal of self-funding is to provide employees with sufficient coverage while combating accelerating medical costs. Under the arrangement, NMEAF accrues an expense for estimated claims and pays claims presented to the administrator from operating funds. A "stop loss" policy was purchased to mitigate the risk of loss by capping the total annual maximum exposure to NMEAF at \$1.2 million. Meanwhile, employee health and dental benefits were held at similar levels to those offered prior to conversion to self-funding.

Health and dental expense was \$538,000 and \$527,000 for the years ended June 30, 2005 and 2004, respectively. The portion of the fiscal year 2005 expense recognized under the self-funded arrangement commencing January 1, 2005 is \$260,545. As of June 30, 2005 the Foundation estimated the liability for unpaid claims at \$200,195. This estimate was based primarily on claims subsequent to year-end and other data.

Claims Liability	Provision for Incurred Claims	Claims Payments	Claims Liability
<u>July 1, 2004</u>	<u> </u>	<u> </u>	<u>June 30, 2005</u>
\$-	\$436,107	\$235,912	\$200,195

(11) Bonus Plan (Management Incentive Plan)

In April 2005 the board of directors approved the implementation of a management incentive plan (the plan) for the fiscal year July 1, 2004 through June 30, 2005. All members of executive management and those directly reporting to them are covered by the plan. Payment amounts are contingent on the level of achievement of specific corporate and team-level objectives. The plan contains both current payout and deferred provisions. At June 30, 2005 the Foundation recognized an expense of \$143,000 to fund the plan for the year.

(12) Commitments and Contingencies

(a) Litigation Matters

NMEAF is involved in various legal actions incident to its operations that, in the opinion of management and NMEAF's legal counsel, will not materially affect NMEAF's financial position or results of its operations. During fiscal year 2005, a private insurance company covered certain of NMEAF's legal actions.

(b) Department of Education Reviews

The ED periodically performs site visits of NMEAF. The last ED site visit was performed in January 2004. The purpose of site visits is to review NMEAF's compliance with the Higher Education Act of 1965, as amended, and the regulations under the FFELP with respect to NMEAF's originating, servicing and collecting of student loans under this program. All ED site visits have been closed.

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(c) *Purchase of Student Loan Notes*

During the normal course of business, NMEAF makes commitments with various banks and other student loan originators to purchase student loan notes. As of June 30, 2005, NMEAF had no commitments outstanding.

(d) *Risk Management*

NMEAF is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets, errors and omissions, injuries to employees, and natural disasters. NMEAF carries commercial insurance to cover losses related to such risks to which it may be exposed.

(e) *Lease Commitments*

During the year ended June 30, 2005 the Foundation leased a backup and recovery site for its data processing facilities under operating leases. The lease was entered into on May 20, 2003 as an occupancy and services agreement for provision of disaster recovery functions. Currently, the monthly minimum recurring charge associated with this agreement is \$2,700, with an initial term of 36 months. NMEAF intends to renew the lease upon its termination in May 2006.

NMEAF leases its internal telecommunications system. This operating lease was entered into on September 15, 2001 for a 60-month term at a minimum monthly amount of \$10,832. An addendum to the lease was executed August 30, 2002, resulting in a monthly payment of \$15,315.

The total expense relating to these lease commitments included on the Statement of Revenues, Expenses and Changes in Net Assets as General and Administration – Other Expense for the year ended June 30, 2005 was \$210,215.

The total minimum operating lease expense commitment under the above leases is due as follows, as of June 30, 2005:

Minimum Operating Lease Commitment	
As of June 30, 2005	
Year ended June 30:	
2006	\$213,480
2007	45,945
	<u>\$259,425</u>