Indiana Secondary Market for Education Loans, Inc.

Financial Statements and Supplemental Information for the Years Ended June 30, 2006 and 2005, and Independent Auditors' Report

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

TABLE OF CONTENTS

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Overview of Indiana Secondary Market for Education Loans, Inc.

Indiana Secondary Market for Education Loans, Inc. ("ISM") was established pursuant to Public Law No. 154 of the 1980 Indiana General Assembly. ISM is the State of Indiana's designated not-for-profit corporation established to purchase student loans and provide enhanced access for Indiana residents pursuing education at post-secondary institutions. Taxable and tax-exempt bonds, note financings, and line of credit facilities are the primary sources of funding for ISM's programs. The State of Indiana has never appropriated funds for the administration of ISM's programs. ISM administers programs for the purchase of loans guaranteed and reinsured by the United States Department of Education ("US DOED") under the Federal Family Education Loan Program ("FFELP").

ISM's programs are designed to facilitate access for all students to educational funding, primarily using federal student loans. Under those programs, ISM purchased loans of $951.52 million and $319.28 million during the fiscal years June 30, 2006 and 2005, respectively. This represents a 198.02% increase in loans purchased from the previous fiscal year and was the result of adding several loan production partners and an increase in the volume of existing partners.

ISM's financial statements consist of the following: the balance sheets, the statements of revenues, expenses and changes in net assets and the statements of cash flows. These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Government Accounting Standards Board. The balance sheets present the financial position of ISM at the end of the fiscal year and include all assets, liabilities and net assets of ISM. The statements of revenues, expenses and changes in net assets present ISM's results of operations and changes in its net assets for the years ended June 30, 2006 and 2005. The statements of cash flows provide information about the sources and uses of ISM's cash resources for the years ended June 30, 2006 and 2005.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)

Condensed Financial Information (in thousands)

Financial Position	2006	2005	2004
Cash and short-term investments	$ 193,027	$ 71,223	$ 69,081
Student loans receivable—net	1,288,564	506,155	299,845
Other assets	41,821	15,846	10,765
Total assets	$ 1,523,412	$ 593,224	$ 379,691
Lines of credit	$ 56,850	$ 28,350	$ 48,800
Taxable bonds payable	1,143,200	243,200	93,200
Tax-exempt bonds payable	234,650	240,650	167,600
Other liabilities	11,213	6,557	2,368
Total liabilities	1,445,913	518,757	311,968
Total net assets	77,499	74,467	67,723
Total liabilities and net assets	$ 1,523,412	$ 593,224	$ 379,691
Operating Results			
Interest on student loans	$ 27,620	$ 11,920	$ 9,221
Special allowance on student loans	23,940	14,457	10,265
Interest income and other	7,442	2,853	1,157
Total operating revenues	59,002	29,230	20,643
Interest expense	40,857	11,082	4,063
Fees and debt issuance costs	2,221	1,215	1,085
Loan servicing and administration	11,697	6,918	5,479
Provision for arbitrage rebate	1,195	3,271	775
Total operating expenses	55,970	22,486	11,402
Change in net assets	$ 3,032	$ 6,744	$ 9,241

MANAGEMENT’S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)

Financial Position

Total assets increased 156.80% from $593.22 million at June 30, 2005 to $1,523.41 million at June 30, 2006. Total liabilities increased 178.72% from $518.76 million to $1,445.91 million during that same period. The increase in bonds payable and the use of a line of credit have enabled ISM to increase student loans receivable by 154.58% during 2006 to $1,288.56 million from $506.16 million at June 30, 2005.

Total assets increased 56.24% from $379.69 million at June 30, 2004 to $593.22 million at June 30, 2005. Total liabilities increased 66.29% from $311.97 million to $518.76 million during that same period. The increase in bonds payable and the use of a line of credit have enabled ISM to increase student loans receivable by 68.81% during 2005 to $506.16 million.

Cash and short-term investments increased by 171.02% from $71.22 million at June 30, 2005 to $193.03 million at June 30, 2006. This increase was due largely to the issuance in early May 2006 of $500.00 million in bonds payable.

Cash and short-term investments increased by 3.10% from June 30, 2004 to $71.22 million at June 30, 2005. Total interest income and other increased 146.59% from 2004 to 2005, primarily due to higher cash and short-term investment balances and other income.

Debt arrangements (lines of credit and bonds payable) increased from $512.20 million at June 30, 2005 to $1,434.70 million at June 30, 2006. This net increase was the result of increased utilization of lines of credit, net proceeds from the December 2005 and May 2006 taxable bond financings used to purchase student loans and $6.00 million of scheduled principal repayments.

Debt arrangements increased from $309.60 million at June 30, 2004 to $512.20 million at June 30, 2005. The net increase was the result of net proceeds from the September and December 2004 bond issues.

Total net assets at June 30, 2006 were $77.50 million representing an increase of 4.07% from $74.47 million at June 30, 2005. Pursuant to Board resolutions on December 17, 2002 and April 22, 2003, ISM has designated $7.10 million for use in higher education enhancement related projects as defined by the Indiana Commission for the Higher Education. This amount is included in unrestricted net assets.

Operating Results

ISM's change in net assets was $3.03 million from operating revenues of $59.00 million for the fiscal year ended June 30, 2006, compared to $6.74 and $29.23 million, respectively, for the prior fiscal year ended. The current year change in net assets was primarily due to the $782.40 million increase in the student loan portfolio and the interest and special allowance income earned related thereto. Additionally, interest expense on debt arrangements (lines of credit and bonds payable) increased resulting from increases in related interest rates.

Total operating revenues increased 101.85%, from $29.23 million for the fiscal year ended June 30, 2005, to $59.00 million for the fiscal year ended June 30, 2006. Interest on student loans increased 123.88% due to increasing interest rates and the increase in ISM's student loan portfolio. The special allowance on student loans also increased from increasing interest rates and the effect of significantly higher loan balances on low fixed rate consolidation loans. ISM retains loans financed with tax-exempt proceeds originally issued prior to October 1, 1993 ("pre-1993 financings"). Loans financed with pre-1993 financings receive a special allowance at ½ the rate on comparably taxable loans, subject to a 9.50% minimum return to the lender. Currently, loans in this category account for less than 15% of ISM's overall loan portfolio.

Total operating revenues increased from $20.64 million for the fiscal year ended June 30, 2004, to $29.23 million for the fiscal year ended June 30, 2005. Interest on loans increased from 2004 to 2005 due to increasing general interest rates and the increase in the student loan portfolio. The special allowance on student loans increased from 2004 to 2005 because of increasing interest rates and the effect of pre-1993 financings.

Total operating expenses increased 148.91% from $22.49 million for the fiscal year ended June 30, 2005, to $55.97 million for the fiscal year ended June 30, 2006. This increase is directly related to an increase in loan servicing and administration expenses of $4.78 million incurred to support higher loan volumes and in-house loan servicing, the increase in interest expense on debt arrangements of $29.78 million resulting from both the increase in debt arrangements (lines of credit and bonds payable) and an increase in the related interest rates.

Total operating expenses increased from $11.40 million for the fiscal year ended June 30, 2004, to $22.49 million for the fiscal year ended June 30, 2005. This increase is related to loan servicing infrastructure expenses, higher interest expenses on financings, and additional staffing expenses to support higher loan volumes and an increase in the provision for arbitrage rebate.

Deloitte & Touche LLP
Bank One Center/Tower
111 Monument Circle
Suite 2000
Indianapolis, IN 46204-5120
USA

Tel: +1 317 464 8600
Fax: +1 317 464 8500
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Indiana Secondary Market for Education Loans, Inc.
Indianapolis, Indiana

We have audited the accompanying balance sheets of Indiana Secondary Market for Education Loans, Inc. ("ISM"), a component unit of the State of Indiana, as of June 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the management of ISM. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ISM's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of ISM as of June 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 to 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of ISM's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

October 9, 2006

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

BALANCE SHEETS
AS OF JUNE 30, 2006 AND 2005
(In thousands)

	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and short-term investments:		
Unrestricted	$ 187,411	$ 66,802
Designated	5,616	4,421
Total cash and and short-term investments	193,027	71,223
Student loans receivable—net	48,158	4,970
Accrued interest receivable—student loans receivable	25,184	10,576
Accrued interest receivable—cash and short-term investments	833	158
Prepaids and other assets	7,546	1,970
Total current assets	274,748	88,897
NON-CURRENT ASSETS:		
Student loans receivable—net	1,240,406	501,185
Prepaids and other assets	6,109	2,856
Capital assets—net	2,149	286
Total long-term assets	1,248,664	504,327
TOTAL	$ 1,523,412	$ 593,224
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Lines of credit	$ 56,850	$ 28,350
Bonds payable	3,000	6,000
Accounts payable and accrued expenses	3,482	1,049
Accrued interest payable	2,115	1,087
Total current liabilities	65,447	36,486
NON-CURRENT LIABILITIES:		
Bonds payable	1,374,850	477,850
Arbitrage rebate payable	5,616	4,421
Total long-term liabilities	1,380,466	482,271
Total liabilities	1,445,913	518,757
NET ASSETS:		
Invested in capital assets	2,149	286
Unrestricted	69,734	69,760
Restricted	5,616	4,421
Total net assets	77,499	74,467
TOTAL	$ 1,523,412	$ 593,224

See notes to financial statements.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005
(In thousands)

	2006	2005
OPERATING REVENUES:		
Interest on student loans	$ 21,466	$ 9,588
U.S. Secretary of Education:		
Special allowance	23,940	14,457
Interest subsidy	6,154	2,332
Interest income and other	7,442	2,853
Total operating revenues	59,002	29,230
OPERATING EXPENSES:		
Interest expense	40,857	11,082
Fees and debt issuance costs	2,221	1,215
Loan servicing and administration	11,697	6,918
Provision for arbitrage rebate	1,195	3,271
Total operating expenses	55,970	22,486
CHANGE IN NET ASSETS	3,032	6,744
NET ASSETS—Beginning of year	74,467	67,723
NET ASSETS—End of year	$ 77,499	$ 74,467

See notes to financial statements.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005
(In thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Student loan interest and special allowance payments received	$ 36,952	$ 23,839
Purchase of student loans	(957,520)	(324,790)
Principal receipts on student loans	192,910	127,780
Cash received on sale of student loans	14,700	
Cash payments for origination fees and premiums on student loans	(38,936)	(12,175)
Cash received for other operating activities	7,521	4,611
Cash payments for employees and vendors	(11,485)	(7,963)
Net cash used in operating activities	(755,858)	(188,698)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from issuance of bonds	900,000	223,050
Proceeds from lines of credit	284,000	
Repayment of bonds	(6,000)	
Repayment of lines of credit	(255,500)	(20,450)
Payment of debt issuance costs	(3,362)	(1,305)
Interest paid on bonds	(39,829)	(10,335)
Net cash provided by noncapital financing activities	879,309	190,960
CASH FLOWS FROM CAPITAL ACTIVITIES:		
Purchase of capital assets	(2,141)	(120)
Cash received for leasehold incentives	494	
Net cash provided by capital activities	(1,647)	(120)
CHANGE IN CASH AND SHORT-TERM INVESTMENTS	121,804	2,142
CASH AND SHORT-TERM INVESTMENTS—Beginning of year	71,223	69,081
CASH AND SHORT-TERM INVESTMENTS—End of year	$ 193,027	$ 71,223

See notes to financial statements.

(Continued)

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005
(In thousands)

	2006	2005
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH USED IN OPERATING ACTIVITIES:		
Change in net assets	$ 3,032	$ 6,744
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Amortization of loan and bond charges	5,876	2,956
Depreciation on capital assets	209	60
Interest expense	40,857	11,082
Provision for allowance for loan losses	586	60
Provision for arbitrage rebate	1,195	3,271
Gain on sale of student loans	(401)	
Other	(1,269)	
Change in assets and liabilities:		
Increase in student loans receivable	(788,446)	(209,185)
Increase in accrued interest receivable	(15,283)	(2,989)
Increase in prepaids and other assets	(5,675)	(868)
Increase in other liabilities	3,461	171
Net cash used in operating activities	$ (755,858)	$ (188,698)
NONCASH OPERATING ACTIVITY—		
Capitalized interest and payment reapplications	$ 5,999	$ 5,513

See notes to financial statements.

(Concluded)

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business—Indiana Secondary Market for Education Loans, Inc. ("ISM" or the "Company") is a not-for-profit corporation formed to purchase and originate student loans under the Federal Family Education Loan Program ("FFELP") provided for by the Higher Education Act. Outstanding bonds are payable as specified in the resolutions authorizing the related sale of the bonds, are not payable by funds received from taxation, and are not debts of the State of Indiana or any of its political subdivisions. ISM is a major, discretely presented, proprietary component unit of the State of Indiana.

Basis of Presentation and Accounting—ISM's financial statements have been prepared on the basis of the governmental enterprise fund concept which pertains to financial activities that operate similarly to a private business enterprise. The assets of each fund are restricted pursuant to the bond resolutions. For financial statement presentation purposes, the funds have been aggregated into one proprietary fund type. ISM's funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. ISM applies all applicable Financial Accounting Standards Board pronouncements which do not conflict with Governmental Accounting Standards Board ("GASB") pronouncements.

Student Loans Receivable—Student loans receivable are stated at the principal amount outstanding adjusted for an estimated allowance for loan losses, unamortized purchase premiums, and origination fees paid on behalf of banks and borrowers. The related interest income generated from student loans is offset by premium and origination fee amortization expenses. ISM amortizes loan premiums and loan origination fees over the estimated average life of the loan on a straight-line basis ranging from 4 to 10 years, which approximates the effective interest method.

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

The U.S. Department of Education ("US DOED") provides a special allowance to lenders participating in the FFELP. For loans first disbursed prior to January 1, 2000, the special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of 91-day United States Treasury bills, to the average daily unpaid principal balance and capitalized interest of student loans held by the Company. For loans first disbursed from January 1, 2000, through June 30, 2006, the special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of the three-month financial Commercial Paper ("CP") rate, to the average daily unpaid principal balance and capitalized interest of student loans held by the Company. The special allowance is accrued as earned.

Cash and Short-Term Investments—Cash and short-term investments are cash equivalents consisting of United States Treasury bills, commercial paper, and money market mutual funds and Guaranteed Insurance Contracts ("GICs"), which are carried at cost and approximate market, with an original maturity of less than 90 days. ISM is restricted to investments that meet the rating requirements per the bond indenture. At June 30, 2006 and 2005, all short-term investments are money market funds, commercial paper, and GICs. All cash and short-term investments whose proceeds are designated for the payment of arbitrage rebate liabilities are classified as designated cash and short-term investments (see Note 3).

Deposit and investment policies—ISM has not adopted a formal investment policy.

As of June 30, 2006, ISM had the following short-term investments and maturities:

		Investment Maturities (In Years)			
Investment Type	**Fair Value (In Thousands)**	**< 1**	**1 - 5**	**6 - 10**	**> 10**
Guaranteed investment contracts	$ 69,421	$ 69,421			
Money market funds	120,010	120,010			
	$ 189,431	$ 189,431	$	$	$

The following table provides information on the credit ratings associated with ISM's short-term investments as of June 30, 2006.

Investment Type	**Fair Value (In Thousands)**	**S & P**	**Fitch**	**Moody's**
Guaranteed investment contracts	$ 69,421	unrated	unrated	unrated
Money market funds	120,010	AAAm		
	$ 189,431			

As of June 30, 2005, ISM had the following short-term investments and maturities:

		Investment Maturities (In Years)			
Investment Type	**Fair Value (In Thousands)**	**< 1**	**1 - 5**	**6 - 10**	**> 10**
Commercial paper	$ 2,830	$ 2,830			
Guaranteed investment contracts	15,109	15,109			
	$ 17,939	$ 17,939	$	$	$

The following table provides information on the credit ratings associated with ISM's short-term investments as of June 30, 2005:

Investment Type	Fair Value (In Thousands)	S & P	Fitch	Moody's
Commercial paper	$ 2,830	P -1	unrated	A - 1
Guaranteed investment contracts	15,109	unrated	unrated	unrated
	$ 17,939			

Custodial risk is the risk that in the event of bank failure, ISM's deposits may not be returned to it. From time to time, certain short-term investment balances maintained by ISM exceed federally insured limits. As of June 30, 2006, ISM had cash and short-term investment balances of $192,727,000 with custodial risk.

Allowance for Loan Losses—Guarantees on student loans originated after October 1, 1993, provide for a reduced recovery of 98% of loan principal and accrued interest on loans which default. Accordingly, ISM provides for an allowance for the estimated loss associated with the portion not recoverable. This allowance is increased by a provision charged to operations and reduced for losses actually incurred, and is included in the financial statements as a reduction of student loans receivable. At June 30, 2006 and 2005, the allowance for loan losses was $1,165,000 and $579,000, respectively.

In completing the analysis of the adequacy of the allowance for loan losses, past collection experience, delinquency trends and size of the portfolio, economic conditions, and other factors are considered. Significant changes in these factors could impact the allowance and provision for loan losses. A large percentage of ISM's loans have not matured to a point at which predictable loss patterns have developed. Accordingly, the evaluation of the allowance for loan losses is inherently subjective as it requires material estimates that may be subject to change.

Debt Issuance Costs—Debt issue costs are amortized using a method that approximates the effective interest method over the terms of their respective agreements, ranging from 18 months to 40 years. Unamortized debt issue costs are included in prepaids and other assets and totaled $ 6,294,000 and $2,956,000 at June 30, 2006 and 2005, respectively.

Capital Assets—Capital assets consist of office furniture, equipment and leasehold improvements recorded at cost. Depreciation is charged to operations on the straight-line method over the estimated useful lives of the related assets or the term of the lease, which is 3 to 7 years depending on the asset class.

Net Assets—$69,734,000 and $69,760,000 of ISM's net assets and all related revenues are unrestricted at June 30, 2006 and 2005, respectively. ISM does, however, maintain debt and other arrangements which limit the use of assets as described in Note 3. In addition, pursuant to Board resolutions on December 17, 2002 and April 22, 2003, ISM has designated $7,100,000 for use in higher education enhancement related projects as defined by the Indiana Commission for the Higher Education. This amount is included in unrestricted net assets. At June 30, 2006 and 2005, ISM's restricted net assets of $5,616,000 and $4,421,000, respectively, reflect amounts restricted to fund the arbitrage rebate payable (see Note 6) and $2,149,000 and $286,000 reflect amounts invested in capital assets (Note 5).

Loan Income and Related Expenses—Interest and special allowance on loans are recognized as income in the period earned and servicing costs are charged to expense as incurred. Premiums paid for student loans and origination fees paid on behalf of banks and borrowers are amortized using a method which approximates the effective interest method over the estimated life of the loans (10 years). At June 30, 2006 and 2005, unamortized premiums totaled $36,362,000 and $9,113,000, respectively, and unamortized origination fees totaled $10,293,000 and $4,458,000, respectively, and are included in the financial statements as a component of student loans receivable.

Servicing Fee—American Education Services, Nelnet Corporation, Sallie Mae Servicing, Affiliated Computer Services, and Great Lakes Education Loan Services service the majority of ISM's student loan portfolio. Servicing fee expense amounts are included in operating expenses in the statement of revenues and expenses and changes in net assets. In addition, ISM services a portion of the student loan portfolio that is not in repayment status.

Risk Management—ISM is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries. Coverage for these various risks of loss is obtained through commercial insurance. There has been no significant reduction in insurance coverage from the prior year for all categories of risk. Commercial insurance is purchased in an amount that is sufficient to cover ISM's risk of loss. ISM will record an estimated loss from a claim as an expense and a liability if it meets the following requirements: (1) information available indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and (2) the amount of the loss can be reasonably estimated.

Operating Revenues and Expenses—Bond and loan issuances are the principal source of the funds. ISM derives revenue from short-term investments, interest on student loans and the U.S. Secretary of Education. ISM's expenses primarily consist of interest on debt arrangements and loan servicing and administration.

Income Taxes**—**The Company is a tax-exempt organization under the provisions of the Internal Revenue Code, Section 501(c)(3) and, accordingly, no provision for income taxes has been made in the accompanying financial statements.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates that are particularly susceptible to change in the near-term relate to the determination of the arbitrage rebate payable and the allowance for loan losses.

Reclassifications—Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 presentation.

2. STUDENT LOANS RECEIVABLE—NET

Student loans receivable consist of loans made under the Higher Education Act and are carried at their unpaid principal balance net of an allowance for loan losses plus unamortized purchase premiums, origination fees, and transfer fees. Student loans earn interest at various rates ranging from 4.70% to 10.00% depending upon the type of student loan and the date the student loan was made. The principal and accrued interest on student loans is substantially insured by certain guarantee agencies which are reinsured by the federal government. At June 30, 2006 and 2005, the majority of ISM's student loans are guaranteed by United Student Aid Funds, Inc. or the Pennsylvania Higher Education Assistance Authority.

Student loans receivable, net as of June 30, 2006 and 2005, consist of the following:

	2006	2005
	(In Thousands)	
Student loans	$ 1,243,074	$ 493,163
Purchase premiums, origination fees and other—net	46,655	13,571
Less—allowance for loan losses	(1,165)	(579)
	$ 1,288,564	$ 506,155

3. BONDS PAYABLE

The following displays the aggregate changes in bonds payable for the fiscal years as of June 30, 2006 and 2005:

	2006	2005
	(In Thousands)	
Bonds payable—beginning of year	$ 483,850	$ 260,800
Proceeds	900,000	223,050
Repayments	(6,000)	
Bonds payable—end of year	$ 1,377,850	$ 483,850

Bonds payable as of June 30, 2006 and 2005 consist of the following:

	2006	2005
	(In Thousands)	
Education Loan Revenue Bonds - Series 1993	$ 3,000	$ 9,000
Auction Rate Certificates	1,374,850	474,850
	$ 1,377,850	$ 483,850

The Education Loan Revenue Bonds issued in Series 1993 are due in fiscal 2007. Interest is payable semi-annually at rates ranging from 5.90% to 6.00%.

Bonds payable at June 30, 2006 include $1,143.20 million and $231.65 million of taxable and tax-exempt Auction Rate Certificates (“ARCs”), respectively. Bonds payable at June 30, 2005 include $243.20 million and $231.65 million of taxable and tax-exempt ARCs, respectively. The ARCs mature on various dates between December 1, 2030 and May 1, 2046, respectively. Interest on the ARCs ranged from 2.50% to 5.50% and 1.28% to 3.40% during the years ended June 30, 2006 and 2005, respectively, and is payable either at each auction, which occurs every 28 or 35 days as stipulated in the related ARC agreement, or semiannually.

The following table displays scheduled debt maturities and contractual interest payments at June 30, 2006:

Years Ending, June 30:	Principal	Interest	Total
2007	$ 3,000,000	$ 53,016,075	$ 56,016,075
2008		53,016,075	53,016,075
2009		53,016,075	53,016,075
2010		53,016,075	53,016,075
2011		53,016,075	53,016,075
2012-2016		265,080,375	265,080,375
2017-2021		265,080,375	265,080,375
2022-2026		265,080,375	265,080,375
2027-2031	59,000,000	262,936,271	321,936,271
2032-2036		246,622,875	246,622,875
2037-2041	265,850,000	222,631,908	488,481,908
2042-2046	1,050,000,000	169,830,616	1,219,830,616
Total	$ 1,377,850,000	$ 1,962,343,171	$ 3,340,193,171

Bonds of each series are secured by (a) the proceeds derived from the sale of the bonds, (b) eligible loans, and (c) certain accounts established by the respective bond resolutions, including monies and securities therein. ISM maintains a minimum amount of pledged assets as defined by each respective bond indenture. The total of all minimum requirements for all bond issuances at June 30, 2006, was $1,468,737,300 ($528,278,055 at June 30, 2005.)

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

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

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

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

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

Cash and short-term investments as of June 30, 2006 and 2005, consist of the following:

	2006	2005
	(In Thousands)	
Special trust accounts:		
Unrestricted:		
Loan accounts	$ 155,654	$ 50,600
Revenue accounts	6,036	5,015
Designated:		
Rebate accounts	5,616	4,421
Total special trust accounts	167,306	60,036
Operating account (includes $7,100 to the State of Indiana)	25,721	11,187
	$ 193,027	$ 71,223

4. LINES OF CREDIT

ISM maintains line of credit agreements ("Agreements") with KeyBank, N.A., First Indiana Bank, N.A., and Bank of America, N.A. The Agreements are collateralized by loans pledged under the Agreements and certain cash balances on deposit with KeyBank and contain certain financial and restrictive covenants. ISM was in compliance with all covenants as of June 30, 2006 and 2005.

The line of credit agreement with KeyBank, N.A. originally matured on June 30, 2005. On August 8, 2005, ISM renewed the Agreement through June 30, 2007 and increased the maximum amount available for borrowings from $50,000,000 to $75,000,000. Interest on this line of credit is charged based on LIBOR plus the applicable margin, and at June 30, 2006 and 2005, this line of credit balance was $26,850,000 and $28,350,000, respectively.

The line of credit agreement with Bank of America, N.A. was executed on August 18, 2005 and provides for maximum borrowings of $100,000,000 through August 17, 2006. In October 2005, this line of credit was amended to increase ISM's available borrowings to $200,000,000. Interest on this line of credit is charged based on LIBOR plus the applicable margin, and at June 30, 2006, ISM did not have any outstanding borrowings on the line of credit. On August 16, 2006, this line of credit was renewed through August 16, 2007.

The line of credit agreement with First Indiana Bank, N.A. was executed on July 18, 2005 and provides for maximum borrowings of $25,000,000 through February 28, 2006. On February 9, 2006, ISM amended this line of credit to increase available borrowings to $30,000,000. On March 1, 2006, this line of credit was renewed through February 28, 2007. Interest is charged based on LIBOR plus the applicable margin, and at June 30, 2006, this line of credit balance was $30,000,000.

The following table displays the aggregate changes in line of credit borrowings for fiscal years ended June 30, 2006 and 2005:

	2006	2005
	(In Thousands)	
Lines of credit—beginning of year	$ 28,350	$ 48,800
Proceeds	284,000	
Repayments	(255,500)	(20,450)
Lines of credit—end of year	$ 56,850	$ 28,350

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 (in thousands) is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Depreciable capital assets:				
Furniture and equipment	$ 355	$ 1,647	$ (58)	$ 1,944
Leasehold improvements	57	494	(57)	494
Total depreciable capital assets	412	2,141	(115)	2,438
Less accumulated depreciation	126	209	(46)	289
Net depreciable capital assets	$ 286	$ 1,932	$ (69)	$ 2,149

Capital asset activity for the year ended June 30, 2005 (in thousands) is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Depreciable capital assets:				
Furniture and equipment	$ 236	$ 119	$	$ 355
Leasehold improvements	56	1		57
Total depreciable capital assets	292	120		412
Less accumulated depreciation	66	60		126
Net depreciable capital assets	$ 226	$ 60	$	$ 286

6. ARBITRAGE REBATE PAYABLE

In accordance with Section 148 of the Internal Revenue Code of 1986 (the “Code”), as amended, and the regulations promulgated thereunder, ISM is required to pay to the United States Treasury certain amounts related to the ISM tax-exempt bond issues. The amount required to be paid represents the excess of amounts earned over the interest cost of the tax-exempt borrowings as defined in the Code. Non-purpose rebate payments are due every fifth year and when the bonds are retired. Purpose rebate payments are due every tenth year and every fifth year thereafter during the life of each bond issue and when the bonds are retired. The rebate calculation utilizes various assumptions and allows for the selection of alternative calculation options under the Code. At June 30, 2006 and 2005, the estimated arbitrage rebate liability is $5,616,000 and $4,421,000, respectively, which has been provided for in the financial statements. The factors used in determining this estimate are sensitive to change in the future and the change in estimate may be material to the financial statements. However, the ultimate amount payable, if any, is dependent on the investment yields and bond rates in the future.

The following table displays the aggregate changes in the arbitrage rebate payable during the fiscal years ended June 30, 2006 and 2005:

	2006	2005
	(In Thousands)	
Arbitrage rebate payable - beginning of year	$ 4,421	$ 1,150
Additional liability	1,195	3,271
Ending balance	$ 5,616	$ 4,421

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by ISM using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts ISM could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of ISM's financial instruments as of June 30, 2006 and 2005, are as follows:

	2006	
	Carrying Amount	Estimated Fair Value
	(In Thousands)	
ASSETS:		
Cash and short-term investments	$ 193,027	$ 193,027
Student loans receivable—net	1,288,564	1,333,907
Accrued interest receivable	26,017	26,017
LIABILITIES:		
Bonds payable	1,377,850	1,329,468
Lines of credit	56,850	56,850
Accrued interest payable	2,115	2,115

	2005	
	Carrying Amount	Estimated Fair Value
	(In Thousands)	
ASSETS:		
Cash and short-term investments	$ 71,223	$ 71,223
Student loans receivable—net	506,155	517,970
Accrued interest receivable	10,734	10,734
LIABILITIES:		
Bonds payable	483,850	473,951
Line of credit	28,350	28,350
Accrued interest payable	1,087	1,087

Cash and Short-Term Investments—Cash and short-term investments are carried at cost, which approximates fair value.

Student Loans Receivable—Net—Loans are categorized by status (in-school, grace, repayment, and delinquent). The fair value is estimated by discounting the future cash flows using current rates of return required by investors in similar assets, less an estimated allowance for credit losses.

Accrued Interest Receivable—Accrued interest receivable is carried at cost, which approximates fair value.

Bonds Payable—For fixed-rate bonds, fair value was calculated based on quoted current market prices of the bonds. For variable rate bonds, the carrying amount is a reasonable estimate of its fair value.

Lines of Credit—For line of credit borrowings, the carrying amount is a reasonable estimate of its fair value.

Accrued Interest Payable—Accrued interest payable is carried at cost, which approximates fair value.

8. 401(K) RETIREMENT PLAN

ISM established the Indiana Secondary Market 401(k) Retirement Plan (“Plan”) in July 2002. The Plan is a “Safe Harbor 401(k) Plan” as described in the Internal Revenue Code. All employees 18 or older are eligible to participate on the first day of the month following their hire date. Under the Plan, ISM may elect to make a special safe harbor contribution of at least 3% of the participants’ salary. ISM also may contribute a discretionary profit sharing benefit if the participants are employed at the end of the Plan year. ISM also matches participant contributions for an amount equal to 100% of participant contributions to a maximum of 4% of the participant’s annual earnings. Participants vest in ISM contributions 100% after one year of service. ISM’s contributions to the Plan during fiscal years 2006 and 2005 were approximately $175,000 and $109,000, respectively. The employees of ISM contributed approximately $166,000 and $112,000 to the Plan during fiscal years 2006 and 2005, respectively.

9. COMMITMENT

ISM leases office space under the terms of a non-cancellable operating lease. Future minimum lease payments under this operating lease at June 30, 2006, are as follows:

Years Ending, June 30:	
2007	$ 181,000
2008	365,000
2009	371,000
2010	376,000
2011	382,000
Thereafter	1,789,000
	$ 3,464,000

Lease expense under this operating lease was approximately $202,000 and $182,000 for the fiscal years ended June 30, 2006 and 2005, respectively.

10. SUBSEQUENT EVENTS

In July 2006, ISM sold approximately $76,100,000 of student loans and recognized a gain on the sale of these loans.

On August 18, 2006, ISM's Board of Directors authorized a warehousing facility (the "VFN Loan") with UBS Real Estate Securities, Inc., as lender, in an amount of up to $250,000,000. The VFN Loan was executed on August 23, 2006 and expires on August 21, 2007.

* * * * * *