

OFFICIAL STATEMENT DATED JULY 20, 2004

(DTC BOOK-ENTRY ONLY)  
ONE NEW AND ONE REFUNDING ISSUE

Ratings: (See "RATINGS" herein)

*The 2004 Series A Bonds have not been structured to afford investors therein any exclusion from income of the interest thereon from federal, state or local income or other taxation. In the opinion of Best & Flanagan LLP, of Minneapolis, Minnesota, Bond Counsel, under federal and State of Minnesota laws, regulations, rulings and decisions in effect on the date of delivery of the 2004 Series B Bonds, assuming compliance with the covenants set forth in the Indenture, the interest on the 2004 Series B Bonds is not includable in gross income for federal income tax purposes or in taxable net income for the purpose of Minnesota income taxes, except for Minnesota corporate and bank excise taxes measured by income. Interest on the 2004 Series B Bonds is an item of tax preference for purposes of federal and State of Minnesota alternative minimum tax ("AMT") applicable to the recipient. See "TAX MATTERS" herein.*



**\$155,500,000**  
**MINNESOTA HIGHER EDUCATION SERVICES OFFICE**  
**Supplemental Student Loan Program Revenue Bonds**  
**\$67,000,000                      \$88,500,000**  
**2004 Series A (Taxable)                      2004 Series B (Tax Exempt)**  
**(Reset Auction Mode Securities – RAMS™)**  
**Price: 100%**

**Dated Date:** Date of Issuance

**Due:** May 1, 2039

The Minnesota Higher Education Services Office ("MHESO") Supplemental Student Loan Program Revenue Bonds 2004 Series A (Taxable) (the "2004 Series A Bonds") and 2004 Series B (Tax Exempt) (the "2004 Series B Bonds") (the 2004 Series A Bonds and the 2004 Series B Bonds collectively being the "2004 Series Bonds") are special, limited obligations of MHESO payable solely from the money and investments held by Wells Fargo Bank, N.A., as trustee (the "Trustee"), pursuant to the General Indenture, dated as of November 1, 1999 (the "General Indenture"), as supplemented and amended by the First Supplemental Indenture, dated as of November 1, 1999, the Second Supplemental Indenture and the Third Supplemental Indenture, each dated as of January 1, 2002, the Fourth Supplemental Indenture and the Fifth Supplemental Indenture, each dated as of June 1, 2003, and the Sixth Supplemental Indenture and the Seventh Supplemental Indenture, each dated as of July 1, 2004 (the General Indenture, as so supplemented and amended being referred to as the "Indenture"), between MHESO and the Trustee. The 2004 Series Bonds are being offered initially as Reset Auction Mode Securities – RAMS™ ("RAMS") as more fully described herein. This Official Statement only discusses the 2004 Series Bonds in auction rate mode.

The 2004 Series Bonds will be issued in fully registered form in denominations of \$100,000 or any integral multiple thereof and, when issued, will be registered in the name of Cede & Co. as nominee of The Depository Trust Company ("DTC"). DTC will act as securities depository for the 2004 Series Bonds. Individual purchases may be made in the Book-Entry Form only and Beneficial Owners will not receive certificates representing their 2004 Series Bonds purchased. Wells Fargo Bank, N.A. (the "Paying Agent") or its successor as Paying Agent will make payments of principal, redemption price, and interest with respect to the 2004 Series Bonds directly to DTC so long as DTC is the registered owner of the 2004 Series Bonds. Disbursement of such payments to DTC Participants (as defined herein) is DTC's responsibility and disbursement of such payments to the Beneficial Owners is the responsibility of DTC Participants. See "THE 2004 SERIES BONDS – Book-Entry Only System" herein.

Each series of the 2004 Series Bonds will bear interest for an initial period at the respective rates provided in the Indenture. Thereafter, the 2004 Series A Bonds will bear interest at an Auction Rate based initially on 28-day Auction Periods commencing September 9, 2004 and the 2004 Series B Bonds will bear interest at an Auction Rate based initially on 35-day Auction Periods commencing September 2, 2004. Interest on the 2004 Series Bonds, while outstanding as RAMS and prior to a conversion to another interest rate mode as described in "RESET AUCTION MODE SECURITIES" herein, is payable with regard to the 2004 Series A Bonds in arrears on the first business day of each succeeding Auction Period commencing September 9, 2004 until maturity or earlier redemption, and with regard to the 2004 Series B Bonds on each May 1 and November 1 commencing November 1, 2004 until maturity or earlier redemption. The applicable Auction Rate and Auction Periods shall be established from time to time pursuant to the Auction Procedures described herein. Each series of the 2004 Series Bonds, while outstanding as RAMS, are also subject to conversion to another interest rate mode as described in "RESET AUCTION MODE SECURITIES" herein. In such event, such series of the 2004 Series Bonds will be subject to mandatory tender for purchase.

The 2004 Series Bonds are being issued to provide MHESO with funds to (i) refund \$68,500,000 in outstanding obligations associated with the Minnesota Higher Education Coordinating Board's 1992, 1993, and 1994 Indentures of Trust, (ii) finance and refinance Student Loans originated under its Supplemental Student Loan Program (the "Program") and (iii) fund the Debt Service Reserve Fund. See "SOURCES AND USES OF FUNDS" herein.

The 2004 Series Bonds are designated Class I Bonds under the Indenture. MHESO has previously issued under the Indenture \$61,200,000 Supplemental Student Loan Program Revenue Bonds 1999 Series A (Taxable) (the "1999 Series Bonds"); \$68,200,000 Supplemental Student Loan Program Revenue Bonds 2002 Series A (Taxable) (the "2002 Series A Bonds") and \$27,100,000 Supplemental Student Loan Program Revenue Bonds 2002 Series B (Tax Exempt) (the "2002 Series B Bonds") (the 2002 Series A Bonds and the 2002 Series B Bonds collectively being the "2002 Series Bonds"); and \$64,700,000 Supplemental Student Loan Program Revenue Bonds 2003 Series A (Taxable) (the "2003 Series A Bonds") and \$10,300,000 Supplemental Student Loan Program Revenue Bonds 2003 Series B (Tax Exempt) (the "2003 Series B Bonds") (the 2003 Series A Bonds and the 2003 Series B Bonds collectively being the "2003 Series Bonds"). The 1999 Series Bonds, the 2002 Series Bonds and the 2003 Series Bonds constitute Class I Bonds, of which the entire original principal amount is outstanding. Each of the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds are on a parity with respect to the right to payment of principal and interest under the Indenture.

The 2004 Series Bonds, while outstanding as RAMS, are subject to redemption and mandatory tender prior to maturity as described in "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provisions."

Payment of the principal of and interest (but not any Carry-over Amount on the 2004 Series A Bonds, as defined hereinafter) on the 2004 Series Bonds, when due, is to be insured by financial guaranty insurance policies to be issued by MBIA Insurance Corporation (the "Bond Insurer" or "MBIA") simultaneously with the delivery of the 2004 Series Bonds.



**THE 2004 SERIES BONDS AND INTEREST THEREON DO NOT CONSTITUTE OR GIVE RISE TO A PECUNIARY LIABILITY OF THE STATE OF MINNESOTA, OR A GENERAL OR MORAL OBLIGATION OR A PLEDGE OF THE FULL FAITH AND CREDIT OF MHESO, THE STATE OF MINNESOTA OR ANY AGENCY OR POLITICAL SUBDIVISION THEREOF. NEITHER THE FAITH NOR CREDIT NOR THE TAXING POWER OF THE STATE OF MINNESOTA OR ANY AGENCY OR POLITICAL SUBDIVISION THEREOF (INCLUDING MHESO) IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR THE INTEREST ON THE 2004 SERIES BONDS. MHESO HAS NO TAXING POWER.**

The 2004 Series Bonds are offered when, as and if issued and received by RBC Dain Rauscher Inc. (the "Underwriter"), subject to prior sale and to the approval of legality by Best & Flanagan LLP, Minneapolis, Minnesota, Bond Counsel to MHESO. Certain legal matters will be passed upon for the Underwriter by its counsel, Dorsey & Whitney LLP, Minneapolis, Minnesota. It is expected that the 2004 Series Bonds will be available for delivery at DTC on or about July 29, 2004 (the "Closing Date").

**RBC Dain Rauscher Inc.**

RAMS™ is a trademark of RBC Dain Rauscher Inc.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

No dealer, broker, sales representative or other person has been authorized by MHESO or the Underwriter to give any information or to make any representations other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by MHESO or the Underwriter. The information contained in this Official Statement has been obtained from MHESO, DTC, the Bond Insurer, Nelnet, Inc. (the "Servicer" or "Nelnet") and other sources that are believed to be reliable. Except for information concerning MHESO, such information is not to be construed as a representation by MHESO. Information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of MHESO since the date hereof. This Official Statement contains, in part, estimates and matters of opinion that are not intended as statements of fact, and no representation or warranty is made as to the correctness of such estimates and opinions or that they will be realized.

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information.

References in this Official Statement to laws, rules, regulations, agreements and any other documents do not purport to be comprehensive or definitive. All references to such documents are qualified in their entirety by reference to the particular document, the full text of which may contain qualifications of and exceptions to statements made herein. Where full texts have not been included as appendices hereto, they will be available for inspection at the principal corporate trust office of the Trustee and, upon request, copies are available from the Underwriter at RBC Dain Rauscher Inc., 60 South Sixth Street, Minneapolis, Minnesota 55402, Attention: Public Finance Department.

IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED.

The 2004 Series Bonds have not been registered with the Securities and Exchange Commission by reason of the provisions of Section 3(a)(2) of the Securities Act of 1933, as amended. This Official Statement does not constitute an offer to sell or the solicitation of any offer to buy, and there shall not be any sale of the 2004 Series Bonds by any person in any state in which it is unlawful for such person to make such offer, solicitation or sale. The registration or qualification of these securities in accordance with applicable provisions of securities laws of the jurisdictions in which the 2004 Series Bonds may be registered or qualified and the exemption from registration or qualification in other jurisdictions shall not be regarded as a recommendation thereof. No jurisdiction or any agency of any jurisdiction has passed upon the merits of the 2004 Series Bonds or the accuracy or completeness of this Official Statement. Any representation to the contrary may be a criminal offense.

Certain of the parties involved in this financing have agreed to indemnify certain other parties for any untrue statement of a material fact contained in this Official Statement or any omission to state a material fact necessary to be stated in this Official Statement in order to make the statements contained herein not misleading.

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## **SUMMARY STATEMENT**

*The following information is furnished solely to provide limited introductory information regarding the 2004 Series Bonds and does not purport to be comprehensive. All such information is qualified in its entirety by reference to the more detailed descriptions appearing in this Official Statement, including the appendices hereto. No person is authorized to detach this Summary Statement from this Official Statement or to otherwise use it without this entire Official Statement.*

Issuer:	The Minnesota Higher Education Services Office, an executive branch agency of the State of Minnesota (the "State").
The 2004 Series Bonds:	\$67,000,000 Supplemental Student Loan Program Revenue Bonds 2004 Series A (Taxable) and \$88,500,000 Supplemental Student Loan Program Revenue Bonds 2004 Series B (Tax Exempt).
Interest Payments:	<p>Interest on the 2004 Series A Bonds while outstanding as RAMS and prior to a change in the Interest Payment Date as described herein is payable in arrears on September 9, 2004 and thereafter on the first Business Day of each succeeding Auction Period until maturity or earlier redemption.</p> <p>Interest on the 2004 Series B Bonds while outstanding as RAMS is payable on each May 1 and November 1 commencing November 1, 2004, until maturity or earlier redemption. The method of computing interest on either or both series of the 2004 Series Bonds may be converted to another interest rate mode. See "RESET AUCTION MODE SECURITIES" herein.</p> <p>The Auction Periods and Interest Payment Dates for the 2004 Series Bonds are subject to change. See "RESET AUCTION MODE SECURITIES – 2004 Series A Bonds (Taxable) – Changes in Auction Periods or Auction Date" and "RESET AUCTION MODE SECURITIES – 2004 Series B Bonds (Tax Exempt) – Changes in Auction Periods or Auction Date" herein.</p>
Security and Source of Repayment:	The 2004 Series Bonds, as well as all other Bonds issued or to be issued under the Indenture (including the 1999 Series Bonds, the 2002 Series Bonds and the 2003 Series Bonds), are secured by MHESO's pledge to the Trustee under the Indenture of (i) all Student Loans, including agreements and notes evidencing the same or extensions or renewals thereof; (ii) all proceeds of the 2004 Series Bonds, Revenues and any other amounts contained in the Funds and Accounts until their use or release from the Funds and Accounts, including amounts in the Debt Service Reserve Fund, which may take the form of moneys, securities, accounts, chattel paper, instruments, and general intangibles; and (iii) all rights of MHESO in and to the Servicing Agreement as it relates to Student Loans held by the Trustee under the Indenture.
Bond Insurance:	Payment of the principal of and interest on the 2004 Series Bonds (but not any Carry-over Amounts on the 2004 Series A Bonds) when due without regard to any acceleration is to be insured by a separate Financial Guaranty Insurance Policy on each series of the 2004 Series Bonds, to be issued by the Bond Insurer simultaneously with the delivery of the 2004 Series Bonds.

Use of Bond Proceeds:	The 2004 Series Bond proceeds are to be applied to (1) refund \$68,500,000 in outstanding obligations associated with the Minnesota Higher Education Coordinating Board's 1992, 1993, and 1994 Indentures of Trust, (2) finance and refinance Student Loans originated under the Program (See "THE SUPPLEMENTAL STUDENT LOAN PROGRAM" herein) and (3) fund the Debt Service Reserve Fund.
Redemption and Mandatory Tender:	The 2004 Series Bonds are subject to optional redemption and mandatory tender prior to maturity, as described herein. The 2004 Series B Bonds are also subject to mandatory redemption, as described herein.
Additional Bonds and Other Obligations:	<p>To date, MHESO has issued under the General Indenture dated as of November 1, 1999, as supplemented and amended by the First Supplemental Indenture, dated as of November 1, 1999, between MHESO and the Trustee, its \$61,200,000 Supplemental Student Loan Program Revenue Bonds 1999 Series A (Taxable), as supplemented and amended by the Second Supplemental Indenture, dated as of January 1, 2002, between MHESO and the Trustee, its \$68,200,000 Supplemental Student Loan Program Revenue Bonds 2002 Series A (Taxable), as supplemented and amended by the Third Supplemental Indenture, dated as of January 1, 2002, between MHESO and the Trustee, its \$27,100,000 Supplemental Student Loan Program Revenue Bonds 2002 Series B (Tax Exempt), as supplemented and amended by the Fourth Supplemental Indenture, dated as of June 1, 2003, between MHESO and the Trustee, its \$64,700,000 Supplemental Student Loan Program Revenue Bonds 2003 Series A (Taxable), and as supplemented and amended by the Fifth Supplemental Indenture, dated as of June 1, 2003, between MHESO and the Trustee, its \$10,300,000 Supplemental Student Loan Program Revenue Bonds 2003 Series B (Tax Exempt). The 2004 Series Bonds will be on a parity with the 1999 Series Bonds, the 2002 Series Bonds and the 2003 Series Bonds with respect to the right to payment of principal and interest under the Indenture. The Indenture permits the issuance of additional Bonds, which may be issued on a parity with or subordinate to the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds, with the consent of the Bond Insurer, under the terms and conditions described herein.</p> <p>The Minnesota Higher Education Coordinating Board ("MHECB") issued under an Indenture of Trust, dated as of July 1, 1992, as supplemented and amended by a First Supplemental Indenture of Trust, dated as of September 1, 1992, between MHECB and the Trustee, its \$10,000,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992A (the "Series 1992A Bonds"), \$10,000,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992B (the "Series 1992B Bonds"), and \$10,000,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992C (the "Series 1992C Bonds") (the Series 1992A Bonds, the Series 1992B Bonds, and the Series 1992C Bonds collectively being the "Series 1992 Bonds"). MHECB issued under an Indenture of Trust, dated as of December 1, 1993, between MHECB and the Trustee, its \$20,000,000 Supplemental Student Loan Program Variable Rate Refunding Bonds, Series 1993 (the "Series 1993 Bonds"). MHECB issued under an Indenture of Trust, dated as of November 1, 1994, between MHECB and First Trust National Association, Saint Paul, Minnesota, its \$18,500,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1994B (the "Series 1994B Bonds"). The Series 1992 Bonds, the Series 1993 Bonds and the Series 1994B Bonds are currently outstanding but will be refunded by the 2004 Series B Bonds.</p>

Special Limited Obligations:

The 2004 Series Bonds are special limited, not general, obligations of MHESO payable solely from the Trust Estate created under the Indenture. The 2004 Series Bonds do not constitute a general obligation of the State or any agency or political subdivision thereof, nor a pecuniary liability or charge against the general credit or taxing power of any of them. MHESO has no taxing power. Neither the full faith nor credit of MHESO, the State or any agency or political subdivision of the State has been pledged to or secures the 2004 Series Bonds.

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## **INTRODUCTORY STATEMENT**

**\$67,000,000**  
**MINNESOTA HIGHER EDUCATION SERVICES OFFICE**  
**SUPPLEMENTAL STUDENT LOAN PROGRAM REVENUE BONDS**  
**2004 SERIES A (TAXABLE)**

**\$88,500,000**  
**MINNESOTA HIGHER EDUCATION SERVICES OFFICE**  
**SUPPLEMENTAL STUDENT LOAN PROGRAM REVENUE BONDS**  
**2004 SERIES B (TAX EXEMPT)**

**RESET AUCTION MODE SECURITIES – RAMS™**

**(DTC BOOK-ENTRY ONLY)**

This Official Statement, including the cover page and the Appendices hereto, sets forth certain information concerning the \$67,000,000 Supplemental Student Loan Program Revenue Bonds 2004 Series A (Taxable) and the \$88,500,000 Supplemental Student Loan Program Revenue Bonds 2004 Series B (Tax Exempt) to be issued by the Minnesota Higher Education Services Office. The 2004 Series Bonds will be issued pursuant to the General Indenture, dated as of November 1, 1999, as heretofore supplemented and amended by the First Supplemental Indenture, dated as of November 1, 1999, as further supplemented and amended by the Second Supplemental Indenture and the Third Supplemental Indenture, each dated as of January 1, 2002, as further supplemented and amended by the Fourth Supplemental Indenture and the Fifth Supplemental Indenture, each dated as of June 1, 2003, and as further supplemented and amended by the Sixth Supplemental Indenture and the Seventh Supplemental Indenture, each dated as of July 1, 2004, between MHESO and Wells Fargo Bank, N.A., as trustee, and in accordance with the provisions of Minnesota Statutes, Sections 136A.15 to 136A.179 (the "Act").

EXCEPT AS EXPRESSLY PROVIDED HEREIN, THIS OFFICIAL STATEMENT PROVIDES INFORMATION RELEVANT TO THE 2004 SERIES BONDS ONLY AS OF THE DATE OF THIS OFFICIAL STATEMENT. THIS OFFICIAL STATEMENT SPEAKS ONLY AS OF ITS DATE SHOWN ON THE COVER PAGE HEREOF, AND THE INFORMATION CONTAINED HEREIN IS SUBJECT TO CHANGE. THIS OFFICIAL STATEMENT DISCUSSES THE 2004 SERIES BONDS IN AUCTION RATE MODE ONLY.

MHESO will use the net proceeds of the sale of the 2004 Series Bonds to (1) refund \$68,500,000 in outstanding obligations associated with the Minnesota Higher Education Coordinating Board's 1992, 1993, and 1994 Indentures of Trust, (2) finance and refinance Student Loans originated under the Program and (3) fund the Debt Service Reserve Fund.

On the Closing Date, the Trustee shall deposit the following amounts into the 2004 Series Bond Accounts of the following funds:

- From the net proceeds of the 2004 Series A Bonds, an amount equal to \$1,340,000 to the 2004 Series A Account of the Debt Service Reserve Fund and an amount equal to \$1,770,000 to the 2004 Series B Account of the Debt Service Reserve Fund (which equals the initial Debt Service Reserve Requirements for the 2004 Series Bonds).
- From the remaining net proceeds of the 2004 Series A Bonds, an amount equal to \$63,890,000 to the 2004 Series A Account of the Acquisition Fund.
- From the net proceeds of the 2004 Series B Bonds, an amount equal to \$30,000,000 to the 1992 Redemption Fund upon receipt of a like principal amount of Student Loans previously financed with proceeds of the Series 1992 Bonds, an amount equal to \$20,000,000 to the 1993 Redemption Fund upon receipt of approximately \$18,600,000 principal amount of Student Loans previously financed with proceeds of the Series 1993 Bonds and approximately \$1,400,000 (in cash and Student Loans) remaining in the Series 1993 Debt Service Reserve Fund, and an amount equal to \$18,500,000 to the

1994 Redemption Fund upon receipt of a like principal amount of Student Loans previously financed with proceeds of the Series 1994B Bonds.

- From the remaining net proceeds of the 2004 Series B Bonds, an amount equal to \$20,000,000 to the 2004 Series B Account of the Acquisition Fund.

MHESO will pay Costs of Issuance from sources other than 2004 Series Bond proceeds. See "SOURCES AND USES OF FUNDS" herein.

The Student Loans to be held in the Student Loan Fund (including those financed and refinanced with the proceeds of the 2004 Series Bonds) have been or will have been originated by MHESO under the Program, are not insured or guaranteed but do require a cosigner. The Revenues derived from repayments of Student Loans held in the Student Loan Fund, amounts on deposit in the Debt Service Reserve Fund, the Revenue Fund, the Acquisition Fund and the Surplus Fund, and the investment income on these Funds are pledged to the payment of the 2004 Series Bonds and any other Bonds issued under the Indenture.

The Indenture provides that Bonds issued thereunder, including the 2004 Series Bonds, be designated a priority Class, with Class I being the highest priority, and the order of priority decreasing as the Class Roman numeral increases. The 2004 Series Bonds constitute Class I Bonds. MHESO has previously issued and has outstanding under the Indenture its \$61,200,000 Supplemental Student Loan Program Revenue Bonds 1999 Series A (Taxable), its \$68,200,000 Supplemental Student Loan Program Revenue Bonds 2002 Series A (Taxable), its \$27,100,000 Supplemental Student Loan Program Revenue Bonds 2002 Series B (Tax Exempt), its \$64,700,000 Supplemental Student Loan Program Revenue Bonds 2003 Series A (Taxable) and its \$10,300,000 Supplemental Student Loan Program Revenue Bonds 2003 Series B (Tax Exempt). The 1999 Series Bonds, the 2002 Series Bonds and the 2003 Series Bonds constitute Class I Bonds, of which the entire original principal amount is outstanding. Each series of the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds are on a parity with respect to the right to payment of principal and interest under the Indenture. See "SECURITY AND SOURCE OF REPAYMENT" herein.

The 2004 Series Bonds are subject to optional redemption and mandatory tender prior to maturity at a price of par plus accrued interest, without premium. The 2004 Series B Bonds are also subject to mandatory redemption. See "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provisions" herein.

The principal amount of Bonds that may be issued under the Indenture is not limited. The 1999 Series Bonds, the 2002 Series Bonds, the 2003 Series Bonds and the 2004 Series Bonds, together with any additional Bonds issued under the Indenture, are herein referred to as the "Bonds." MHESO may, from time to time, issue additional Bonds in one or more series of one or more classes, subject to the limitation under the Act that the aggregate amount of revenue bonds issued by MHESO that are outstanding at any one time, not including refunded bonds or otherwise defeased or discharged bonds, may not exceed \$850,000,000. MHESO may issue additional Bonds on a parity with the 2004 Series Bonds or of a class with a lower priority than the 2004 Series Bonds. MHESO may also issue bonds pursuant to another indenture.

The 2004 Series Bonds are special, limited obligations of MHESO payable solely from the Trust Estate created under the Indenture, including the Student Loans held in the Student Loan Fund and from the money and other investments held by the Trustee as part of the Trust Estate pursuant to the Indenture.

Payment of the principal of and interest (but not any Carry-over Amounts on the 2004 Series A Bonds) on each series of the 2004 Series Bonds when due without regard to any acceleration is to be insured by a separate financial guaranty insurance policy on each series of the 2004 Series Bonds (collectively, the "Financial Guaranty Insurance Policy" or "MBIA Policy") to be issued by the Bond Insurer simultaneously with the delivery of each series of the 2004 Series Bonds, as more fully described herein under "BOND INSURANCE." The form of the Financial Guaranty Insurance Policy is included in Appendix VIII hereto. Such information has been provided by the Bond Insurer and neither MHESO nor the Underwriter takes any responsibility for the accuracy or completeness thereof.

This Official Statement and the Appendices hereto contain descriptions of, among other matters, the 2004 Series Bonds, MHESO, the Program, the Financial Guaranty Insurance Policy, the Bond Insurer, the Auction Procedures and the Indenture. Such descriptions and information do not purport to be comprehensive or definitive. All references herein to the documents referred to above are qualified in their entirety by reference to such documents,



and references herein to the 2004 Series Bonds are qualified in their entirety by reference to the form thereof included in the Indenture. Copies of such documents and other documents described herein will be available for inspection at the principal corporate trust office of the Trustee and, upon request, copies of such documents are available during the offering period from the Underwriter at RBC Dain Rauscher Inc., 60 South Sixth Street, Minneapolis, Minnesota 55402, Attention: Public Finance Department.

All capitalized terms used herein that are not otherwise defined shall have the meanings ascribed thereto in the Indenture and as described in Appendix II hereto, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE."

### ***Bondholders' Risks***

This Official Statement, including all Appendices hereto, should be read in its entirety for an understanding of the security for and the risks that may be associated with ownership of the 2004 Series Bonds. There follows under this heading a brief summary of selected factors that may be of particular significance to an investor in making an investment decision with respect to the 2004 Series Bonds. Such factors are not intended to be a complete list of all factors which may be material to such decision.

***Lack of Liquidity Facility for RAMS.*** The 2004 Series Bonds, while outstanding as RAMS, will not be supported by a liquidity facility. If an Existing Owner were to submit a Sell Order or a Hold Order subject to an interest rate that is determined to be greater than the Maximum Auction Rate for such Auction Date, and Sufficient Clearing Bids are not obtained on such Auction Date, such Existing Owner will not have its 2004 Series Bonds purchased through the Auction Procedures on such Auction Date. In such event, no assurance can be given that a Broker-Dealer will be able to locate a purchaser prior to the next Auction Date or that Sufficient Clearing Bids will be obtained on any succeeding Auction Date.

***Defaults and Delinquencies on the Student Loans.*** The Revenues derived by MHESO from payments of principal of and interest on the Student Loans could be materially and adversely affected by increases in defaults and delinquencies on payments of principal of and interest on the Student Loans. If the Senior Asset Coverage Ratio falls below 101%, the Indenture requires MHESO to purchase or replace Defaulted Student Loans (as defined below) pledged under the Indenture (see Appendix II hereto, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE – SUMMARIES OF DOCUMENTS – THE SIXTH AND SEVENTH SUPPLEMENTAL INDENTURES – Deposits into Funds and Accounts; Disposition of Proceeds of the Sale of the 2004 Series Bonds; and Use and Disbursements of Funds – Purchase of Defaulted Student Loans") but there is no assurance that sufficient replacement Student Loans or sufficient other funds will be available to MHESO to effect such purchases or replacements if rates of default increase materially. A Defaulted Student Loan is a Student Loan with respect to which either (i) a Default Claim has been filed by the Servicer with MHESO under the Servicing Agreement or (ii) any installment of principal or interest was not paid when due and remains unpaid for 165 days or longer.

***Limited Obligations of MHESO.*** The 2004 Series Bonds are special limited, not general, obligations of MHESO payable solely from the Trust Estate created under the Indenture. The 2004 Series Bonds do not constitute a general obligation of the State or any agency or political subdivision thereof, nor a pecuniary liability or charge against the general credit or taxing power of any of them. MHESO has no taxing power. Neither the full faith nor credit of MHESO, the State or any agency or political subdivision of the State has been pledged to or secures the 2004 Series Bonds.

No assurance can be given that sufficient Revenues will be derived from the Student Loans held in the Student Loan Fund, or any other moneys or investments held under the Indenture which are part of the Trust Estate and available for such purpose, to make payments of the principal of and interest on the 2004 Series Bonds. The Student Loans held under the Indenture are not subject to acceleration of principal in the event of any such deficiency. Although MHESO is obligated to pay certain Program Expenses from sources other than the Trust Estate, if it should fail to do so the Trustee will be required to pay such Program Expenses from amounts in the Trust Estate that would otherwise be used to pay principal of and interest on the 2004 Series Bonds. See "SECURITY AND SOURCE OF REPAYMENT – Cash Flow Projections – Program Expenses" herein.

**Financial Condition of MHESO.** MHESO's audited general purpose financial statements for the periods ended June 30, 2002 and June 30, 2003 are attached hereto as Appendix I. An investor, in making an investment decision with respect to the 2004 Series Bonds, should examine this financial information carefully with the knowledge that none of the assets of MHESO (other than the Trust Estate held under the Indenture, which does not include the Loan Capital Fund) have been pledged to be used by MHESO to make principal and interest payments in respect of the 2004 Series Bonds or any other amounts payable by MHESO under the Indenture. However, the Indenture requires that MHESO pay for costs of issuance, certain Program Expenses and purchases or replacements of Defaulted Student Loans.

**Ratings of the 2004 Series Bonds.** It is a condition to the issuance of the 2004 Series Bonds that Moody's Investors Service assigns the 2004 Series Bonds its long-term rating of "Aaa" and Fitch Ratings assigns the 2004 Series Bonds its long-term rating of "AAA", each with the understanding that upon delivery of the 2004 Series Bonds the Financial Guaranty Insurance Policy insuring the payment when due of the principal of and interest (but not any Carry-over Amount on the 2004 Series A Bonds) on the 2004 Series Bonds will be issued by the Bond Insurer. A rating is not a recommendation to purchase, hold or sell the 2004 Series Bonds, inasmuch as such rating does not comment as to market price or suitability to a particular investor. See "RATINGS" herein. There is no assurance that the ratings will remain for any given period of time or that either rating will not be lowered or withdrawn entirely.

**Interest Rate Risk.** Except in certain circumstances described herein, each of the series of the 2004 Series Bonds will bear interest at an Auction Rate, to be determined by the Auction Agent in accordance with the Auction Procedures described in Appendix III hereto. Each Auction Rate will be the rate that results from the implementation of the Auction Procedures. Auction Rates may change significantly during the period the 2004 Series Bonds are outstanding, subject only to the limitation that such Auction Rate may not exceed the Maximum Auction Rate. See "THE 2004 SERIES BONDS" herein.

The 2004 Series Bonds are secured by Revenues to be derived by MHESO from SELF II and SELF III Student Loans pledged to the Trustee pursuant to the Indenture and deposited in the Student Loan Fund and other amounts available under the Indenture, including, but not limited to, the Debt Service Reserve Fund. Payments of interest on the Student Loans constitute a portion of such Revenues.

The interest rates on the SELF II Student Loans are adjusted quarterly and are currently determined by adding 200 basis points to the quarterly average of the investment interest rates on weekly auctions of 13-week United States Treasury bills. Such Student Loan interest rates are subject to a maximum 200 basis point increase or decrease during any 12-month period.

The interest rates on the SELF III Student Loans are adjusted quarterly and are currently determined by adding 330 basis points to the quarterly average of the three-month London Interbank Offered Rates ("LIBOR"). Such Student Loan interest rates are subject to a maximum 300 basis point increase or decrease during any 12-month period.

The Revenues received from the Student Loans and other amounts available under the Indenture are expected to exceed the total payments of principal of and interest on the 2004 Series Bonds. There is no assurance, however, that the Auction Rates will not increase to a level at which the principal of and interest on the 2004 Series Bonds, together with any costs payable from the Trust Estate, will exceed such Revenues. The amount of increases (or decreases) in an Auction Rate on the 2004 Series Bonds is not limited during any 12-month period but is subject to the Maximum Auction Rate. See Appendix II, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE" and Appendix III, "AUCTION PROCEDURES" herein. MHESO cannot increase or decrease interest rates on SELF II Student Loans by more than two percent (2%) during any twelve-month period and on SELF III Student Loans by more than three percent (3%) during any twelve-month period. In the event interest on the 2004 Series Bonds and Program Expenses that are expected to be paid from the Trust Estate exceed the interest earnings on the Student Loans plus other Revenues from the Trust Estate for a significant period of time, the Revenues could be insufficient to pay principal of and/or interest on the 2004 Series Bonds. Such a result could lead to an Event of Default under the Indenture.

**Condition of Servicer.** The Revenues derived by MHESO from payments of principal of and interest on the Student Loans are dependent upon the ability of the Servicer to properly and promptly collect such amounts. In the event that the Servicer is unable for any reason to properly service the Student Loans, the Revenues to MHESO could be

materially and adversely affected and MHESO would be required to retain a substitute servicer, whose ability to properly service the student loans cannot be assured.

***Enforceability of Remedies.*** The 2004 Series Bonds are payable from the moneys and investments held under the Indenture and available for such purpose. The ability to compel payment under the Indenture and otherwise to enforce the terms and agreements of the Indenture will depend upon the exercise of various remedies specified by the Indenture. The exercise of these remedies may in many instances require judicial actions, which are often subject to discretion and delay. Under existing law, the remedies specified in the Indenture may not be readily available or may be limited. For example, a court may decide not to order the specific performance of covenants contained in the Indenture. The various legal opinions to be delivered concurrently with the delivery of the 2004 Series Bonds will be qualified as to the enforceability of the Indenture by limitations imposed by state and federal laws, rulings and decisions affecting remedies and by bankruptcy, insolvency, reorganization or other laws affecting the enforcement of creditors' rights generally.

***Lack of Perfection of Security Interest in Student Loans.*** The Indenture creates a security interest in favor of the Trustee in all of the assets comprising the Trust Estate, including the Student Loans, to secure payment of, among other things, the principal of and interest on the 2004 Series Bonds. To perfect such security interest in the Student Loans, the Trustee must take (a) possession of the promissory notes evidencing such Student Loans, either directly or constructively through a custodian or bailee, or (b) file a financing statement. The Servicer will hold the original promissory note with respect to each Student Loan as bailee for the Trustee for purposes of perfecting the Trustee's security interest therein and a financing statement will be filed. However, under the terms of the Servicing Agreement, the Servicer will be permitted (so long as the default rate on all Student Loans held as part of the Trust Estate does not exceed 10%) to relinquish possession of the promissory note and related documentation to MHESO, for collection purposes, with respect to each Student Loan as to which a payment has been delinquent 120 days or more. If a third-party purchaser for value and without notice obtains possession of the promissory note, the third-party purchaser's interest would have priority over the security interest of the Trustee. Pursuant to the Indenture, MHESO will be obligated to purchase or replace any Defaulted Student Loan (which includes any Student Loan as to which a payment has been delinquent 165 days or more) within 45 days after becoming a Defaulted Student Loan. After the release of possession of any Student Loan to MHESO as described above, no Event of Default will have occurred under the Indenture unless and until MHESO fails to purchase or replace such Student Loan within the 45-day period referred to above (which could be up to 90 days after such release).

***Additional Bonds.*** The principal amount of Bonds that MHESO may issue under the Indenture is not limited. However, under the Act, the aggregate amount of revenue bonds issued by MHESO and outstanding at any one time, not including refunded bonds or otherwise defeased or discharged bonds, shall not exceed \$850,000,000. As of June 30, 2004, MHESO had outstanding \$300,000,000 of bonds.

In order to (i) acquire, finance or refinance Student Loans, (ii) refund obligations of MHESO and (iii) set aside amounts for a reserve, and to pay costs of issuance, MHESO is authorized to issue Bonds under the Indenture from time to time in one or more series of one or more classes. MHESO has previously issued the 1999 Series Bonds, the 2002 Series Bonds and the 2003 Series Bonds under the Indenture, which are on a parity with the 2004 Series Bonds with respect to the right to payment of principal and interest under the Indenture. MHESO may issue Additional Bonds of a Class on a parity with the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds or of one or more Classes of lower priority than the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds. MHESO has previously issued bonds under separate indentures (see "MINNESOTA HIGHER EDUCATION SERVICES OFFICE – Financial Information" herein) and can issue bonds in the future under separate indentures. Such bonds would not be secured under the Indenture, nor will the assets securing those bonds secure Bonds issued under the Indenture.

Under the Indenture, a Bond Class is a level of priority designated with a Roman numeral, with I being the highest and descending in priority as the numerals increase. The 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds are Class I Bonds.

## **THE 2004 SERIES BONDS**

### ***General***

The 2004 Series Bonds are being issued as Reset Auction Mode Securities. While outstanding as RAMS, the interest rate for each series of 2004 Series Bonds is to be established from time to time pursuant to the Auction Procedures described below under "RESET AUCTION MODE SECURITIES" and in Appendix III – "AUCTION PROCEDURES."

The 2004 Series Bonds are dated and mature as set forth on the cover of this Official Statement and as described herein. The 2004 Series Bonds will be issued in fully registered form in denominations of \$100,000 or any integral multiple thereof and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company. DTC will act as securities depository of the 2004 Series Bonds. Individual purchases may be made in Book-Entry Form only and Beneficial Owners will not receive certificates representing their 2004 Series Bonds purchased. Wells Fargo Bank, N.A. or its successor as Paying Agent will make payments of principal, redemption price, and interest with respect to the 2004 Series Bonds directly to DTC so long as DTC is the registered owner of the 2004 Series Bonds. Disbursement of such payments to DTC Participants (as defined herein) is DTC's responsibility and disbursement of such payments to the Beneficial Owners is the responsibility of DTC Participants. See "Book-Entry Only System" below.

Should MHESO or DTC discontinue use of the book-entry system and certificated 2004 Series Bonds are issued to Beneficial Owners, (i) interest on the 2004 Series Bonds will be paid by check or draft drawn upon the Paying Agent and mailed to registered owners at the address shown on the register of the Registrar; provided that, at the written request of a registered owner of at least \$1,000,000 in aggregate principal amount of the applicable series of the 2004 Series Bonds and upon compliance with certain provisions of the Indenture, interest may be paid by wire transfer, and (ii) principal of the 2004 Series Bonds shall be payable upon presentation and surrender of such 2004 Series Bonds at the principal corporate trust office of the Trustee.

The 2004 Series Bonds are subject to redemption and mandatory tender, as described below in "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provisions."

### ***Book-Entry Only System***

*The information contained in the following paragraphs of this subsection "Book-Entry Only System" has been extracted from a schedule prepared by The Depository Trust Company entitled "SAMPLE OFFERING DOCUMENT LANGUAGE DESCRIBING BOOK-ENTRY ONLY ISSUANCE." The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that MHESO believes to be reliable, but MHESO takes no responsibility for the accuracy thereof.*

The Depository Trust Company, New York, New York will act as securities depository for the 2004 Series Bonds. The 2004 Series Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered 2004 Series Bond certificate will be issued for the 2004 Series A Bonds and for the 2004 Series B Bonds, specified on the cover page hereof, in the respective aggregate principal amount of each series, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Bonds Exchange Act of 1934. DTC holds and provides asset servicing for over two million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over eighty-five countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges

between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. bonds brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

Purchases of 2004 Series Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2004 Series Bonds on DTC's records. The ownership interest of each actual purchaser of each 2004 Series Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interest in the 2004 Series Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the 2004 Series Bonds, except in the event that use of the book-entry system for the 2004 Series Bonds is discontinued or an entire maturity is transferred.

To facilitate subsequent transfers, all 2004 Series Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the 2004 Series Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2004 Series Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2004 Series Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the 2004 Series Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the 2004 Series Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Trustee as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 2004 Series Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal of, redemption premium, if any, and interest payments on the 2004 Series Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from MHESO, the Trustee, or the Paying Agent, on payable date in accordance with their respective holding shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, nor its nominee, the Trustee, the Paying Agent, or MHESO, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payment to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee or the Paying Agent, disbursement of such

payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the 2004 Series Bonds at any time by giving reasonable notice to MHESO, the Trustee, or the Paying Agent. Under such circumstances, in the event that a successor depository is not obtained, 2004 Series Bond certificates are required to be printed and delivered.

MHESO may direct the DTC participants to request or discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, 2004 Series Bond certificates will be printed and delivered.

NEITHER MHESO, THE TRUSTEE, NOR THE PAYING AGENT WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DIRECT PARTICIPANTS, TO INDIRECT PARTICIPANTS, OR TO ANY BENEFICIAL OWNER WITH RESPECT TO (I) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY DIRECT PARTICIPANT, OR ANY INDIRECT PARTICIPANT; (II) ANY NOTICE THAT IS PERMITTED OR REQUIRED TO BE GIVEN TO THE OWNERS OF THE 2004 SERIES BONDS UNDER THE RESOLUTION; (III) THE SELECTION BY DTC OR BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE 2004 SERIES BONDS; (IV) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR REDEMPTION PREMIUM, IF ANY, OR INTEREST DUE WITH RESPECT TO THE 2004 SERIES BONDS; (V) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE OWNER OF THE 2004 SERIES BONDS; OR (VI) ANY OTHER MATTER.

## ***Redemption and Mandatory Tender Provisions***

### **2004 Series A Bonds (Taxable)**

***Optional Redemption.*** The 2004 Series A Bonds shall be subject to optional redemption by MHESO with Credit Confirmation from Eligible Funds, except for amounts paid under the Financial Guaranty Insurance Policy, held by the Trustee and available to be applied to the redemption of the 2004 Series A Bonds.

During the Auction Rate Period, MHESO may redeem the 2004 Series A Bonds, in whole or in part, at the principal amount thereof plus accrued and unpaid interest to the date fixed for redemption, on the first day of each Auction Period (provided that if the Bond Insurer has directed MHESO not to purchase, originate or refinance Student Loans with funds under the Indenture, the Bond Insurer may direct MHESO to so redeem the 2004 Series A Bonds pursuant to the Sixth Supplemental Indenture).

***Mandatory Tender for Purchase upon Fixed Rate Conversion.*** 2004 Series A Bonds shall be subject to mandatory tender for purchase on any Fixed Rate Conversion Date at a price equal to the principal amount thereof plus accrued interest, if any, thereon to the date of purchase. The Trustee is required to give notice of such mandatory tender to the owners of such converted 2004 Series A Bonds subject to purchase at their addresses shown on the books of registry. Such notice shall be sent by first class mail to the owners.

2004 Series A Bonds subject to mandatory tender for purchase on any Fixed Rate Conversion Date shall be required to be delivered to the designated office of the Trustee, or its designated agent for such purposes, at or before 12:00 noon (New York City time) on such date. If a Bondholder fails to deliver any 2004 Series A Bonds subject to mandatory tender for purchase as described herein, and if the Trustee, or its designated agent for such purposes, is in receipt of the purchase price therefor, such 2004 Series A Bonds shall nevertheless be deemed tendered and purchased on the Fixed Rate Conversion Date and shall be an Undelivered Bond as described below under the caption "Undelivered Bonds," and registration of the ownership of such Converted Bond shall be transferred to the purchaser thereof as described under the caption "Undelivered Bonds" below.

***Undelivered Bonds.*** Any 2004 Series A Bonds which are required to be tendered on a Fixed Rate Conversion Date and which are not delivered on the Fixed Rate Conversion Date, and for the payment of which there has been irrevocably held in trust in a segregated subaccount for the benefit of such owner an amount of money sufficient to

pay the purchase price and any accrued interest owing on the purchase date with respect to such 2004 Series A Bonds, shall be deemed to have been purchased, and shall be Undelivered Bonds. In the event of a failure by an owner of 2004 Series A Bonds to tender such 2004 Series A Bonds on or prior to the required date, such owner of such Undelivered Bonds shall not be entitled to any payment other than the purchase price and any unpaid interest due on the purchase date, and Undelivered Bonds in the hands of such non-delivering owner shall no longer accrue interest or be entitled to the benefits of the Indenture, except for the payment of the purchase price and any unpaid interest due on the Tender Date; provided, however, that the indebtedness represented by such Converted Bonds shall not be extinguished, and the Trustee shall transfer, authenticate and deliver such Bonds as provided in the Indenture. Pending delivery of such Undelivered Bonds, the Trustee, or its designated agent, shall hold the purchase price therefore uninvested in a segregated subaccount for the benefit of such owners.

***Notice and Effect of Redemption or Mandatory Tender.*** On the date designated for redemption or mandatory tender upon fixed rate conversion of the 2004 Series A Bonds by notice as provided under the Sixth Supplemental Indenture, the 2004 Series A Bonds so called for redemption or tender shall become due and payable at the stated redemption price or purchase price, as applicable, and to the extent moneys are available therefor, interest shall cease to accrue on such 2004 Series A Bonds. If fewer than all of the outstanding 2004 Series A Bonds are to be redeemed, the 2004 Series A Bonds to be redeemed shall be selected by the Trustee in such manner as the Trustee shall deem fair and reasonable. The Trustee is required under the General Indenture to give notice of redemption as described below (see "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provisions – Notice of Redemption of the 2004 Series A and 2004 Series B Bonds").

#### **2004 Series B Bonds (Tax Exempt)**

***Optional Redemption.*** The 2004 Series B Bonds shall be subject to optional redemption by MHESO with Credit Confirmation from Eligible Funds, except for amounts paid under the Financial Guaranty Insurance Policy, held by the Trustee and available to be applied to the redemption of the 2004 Series B Bonds.

During the Auction Rate Period, MHESO may redeem 2004 Series B Bonds in whole or in part, at the principal amount thereof plus accrued and unpaid interest to the date fixed for redemption, during any Auction Rate Period, on the first day of each Auction Period (provided that if the Bond Insurer has directed MHESO not to purchase, originate or refinance Student Loans with funds under the Indenture, the Bond Insurer may direct MHESO to so redeem Bonds pursuant to the Seventh Supplemental Indenture).

***Mandatory Redemption.*** The 2004 Series B Bonds are subject to mandatory redemption in part on the dates set forth below, at a redemption price of 100% of the principal amount thereof to be redeemed, plus accrued interest to the redemption date, in the aggregate principal amounts set forth below for each such date.

<u>Date</u>	<u>Amount</u>
November 1, 2020	\$20,000,000
May 1, 2022	30,000,000
November 1, 2024	18,500,000

***Mandatory Tender for Purchase Upon Conversion.*** 2004 Series B Bonds shall be subject to mandatory tender for purchase on any Conversion Date at a price equal to the principal amount thereof plus accrued interest, if any, thereon to the date of purchase. The Trustee is required to give notice of such mandatory tender to the owners of such Converted Bonds subject to purchase at their addresses shown on the books of registry. Such notice shall be sent by first class mail to the owners.

Bonds subject to mandatory tender for purchase on any Conversion Date shall be required to be delivered to the designated office of the Trustee, or its designated agent for such purposes, at or before 12:00 noon (New York City time) on such date. If the owner of any Converted Bond which is subject to purchase as described herein fails to deliver such Converted Bond to the Trustee, or its designated agent for such purposes, for purchase on the purchase date, and if the Trustee, or its designated agent for such purposes, is in receipt of the purchase price therefor, such Converted Bond shall nevertheless be deemed tendered and purchased on the Conversion Date and shall be an Undelivered Bond as described below under the caption "Undelivered Bonds," and registration of the ownership of

such Converted Bond shall be transferred to the purchaser thereof as described under the caption "Undelivered Bonds."

***Undelivered Bonds.*** Any 2004 Series B Bonds which are required to be tendered on a Conversion Date and which are not delivered on such Conversion Date, and for the payment of which there has been irrevocably held in trust in a segregated subaccount for the benefit of such owner an amount of money sufficient to pay the purchase price and any accrued interest owing on the purchase date with respect to such 2004 Series B Bonds, shall be deemed to have been purchased, and shall be Undelivered Bonds. In the event of a failure by an owner of 2004 Series B Bonds to tender such 2004 Series B Bonds on or prior to the required date, such owner of such Undelivered Bonds shall not be entitled to any payment other than the purchase price and any unpaid interest due on the purchase date, and Undelivered Bonds in the hands of such non-delivering owner shall no longer accrue interest or be entitled to the benefits of the Indenture, except for the payment of the purchase price and any unpaid interest due on the Tender Date; provided, however, that the indebtedness represented by such 2004 Series B Bonds shall not be extinguished, and the Trustee shall transfer, authenticate and deliver such 2004 Series B Bonds as provided in the Indenture. Pending delivery of such Undelivered Bonds, the Trustee, or its designated agent, shall hold the purchase price therefore uninvested in a segregated subaccount for the benefit of such owners.

***Notice and Effect of Redemption or Mandatory Tender.*** On the date designated for redemption or mandatory tender upon conversion of the 2004 Series B Bonds by notice as provided under the Seventh Supplemental Indenture, the 2004 Series B Bonds so called for redemption or tender shall become due and payable at the stated redemption price or purchase price, as applicable, and to the extent moneys are available therefor, interest shall cease to accrue on such 2004 Series B Bonds. If fewer than all of the outstanding 2004 Series B Bonds are to be redeemed, the 2004 Series B Bonds to be redeemed shall be selected by the Trustee in such manner as the Trustee shall deem fair and reasonable. The Trustee is required under the Indenture to give notice of redemption as described below (see "THE 2004 SERIES BONDS – Redemption and Tender Provisions – Notice of Redemption of the 2004 Series A and 2004 Series B Bonds").

#### **Notice of Redemption of the 2004 Series A and 2004 Series B Bonds**

Not less than 5 Business Days prior to the last date the Trustee can notify owners of a redemption, MHESO shall give the Trustee and the Bond Insurer written notice of (i) its election to redeem 2004 Series Bonds on the redemption date, (ii) the principal amount of 2004 Series Bonds to be redeemed (the redemption date and principal amounts of 2004 Series Bonds to be redeemed are within MHESO's sole discretion), and (iii) any moneys to be applied to the payment of the redemption price.

The Trustee shall give notice by first class mail of the redemption of any 2004 Series Bonds to be redeemed to the owners thereof at their addresses appearing upon the register maintained by the Registrar. While the 2004 Series Bonds are in the Auction Rate Period, such notice shall be given not less than 15 days or more than 60 days prior to the Redemption Date. In addition, the Trustee shall send a second notice not more than 60 days after the redemption date to owners of 2004 Series Bonds to be redeemed who failed to deliver their 2004 Series Bonds for redemption. The Trustee shall also give such notice by certified mail or overnight delivery to securities depositories and to at least 2 national information services at least 2 Business Days in advance of mailed notice to owners.

All notices of redemption of 2004 Series Bonds shall specify:

- (i) the complete name, CUSIP number, interest rate, date of issue, and maturities of the 2004 Series Bonds to be redeemed;
- (ii) the Redemption Date and the place or places where amounts due upon such redemption will be payable;
- (iii) if fewer than all the 2004 Series Bonds are to be redeemed, the letters and numbers or other distinguishing marks of such 2004 Series Bonds to be redeemed;
- (iv) in the case of 2004 Series Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed; and



- (v) that on the Redemption Date the Redemption Price will become due and payable and that from and after such date interest on redeemed 2004 Series Bonds will cease to accrue.

## **RESET AUCTION MODE SECURITIES**

### ***2004 Series A Bonds (Taxable)***

#### **General**

The 2004 Series A Bonds are being issued as RAMS. The 2004 Series A Bonds are dated and mature as set forth on the cover of this Official Statement and as described herein. Certain capitalized terms used herein with respect to the 2004 Series A Bonds are defined in "DEFINITION OF CERTAIN TERMS AND SUMMARY OF INDENTURE," Appendix II to this Official Statement. The following discussion of interest on the 2004 Series A Bonds relates to the 2004 Series A Bonds while outstanding as RAMS, unless otherwise provided.

#### **Interest**

***Interest Payments.*** While the 2004 Series A Bonds bear interest at an Auction Rate, interest accrued on the 2004 Series A Bonds shall be computed on the basis of a year of 360 days for the number of days actually elapsed. The 2004 Series A Bonds shall bear interest from the date thereof payable on each Interest Payment Date.

An "*Interest Payment Date*" means for the 2004 Series A Bonds (a) during an Auction Period of 180 days or more, each May 1 and November 1, and during an Auction Period of less than 180 days, the first Business Day of each succeeding Auction Period, commencing September 9, 2004, except in each case as changed pursuant to Section 3.6 of the Sixth Supplemental Indenture; (b) any day on which 2004 Series A Bonds are subject to mandatory tender for purchase or redemption in whole pursuant to the Sixth Supplemental Indenture, and (c) the Stated Maturity Date of the 2004 Series A Bonds.

The amount of interest distributable to holders of 2004 Series A Bonds bearing interest at an Auction Rate in respect of each \$100,000 in principal amount thereof for any Interest Period or part thereof shall be calculated by the Trustee by applying the Bond Interest Rate for such Interest Period or part thereof to the principal amount of \$100,000, multiplying such product by the actual number of days in the Interest Period or part thereof, dividing by 360, and, if necessary, truncating the resultant figure to the nearest cent. In the event an Interest Payment Date occurs in any Interest Period on a day other than the first day of such Interest Period, the Auction Agent, after confirming the calculation required above, shall calculate the portion of the interest amount payable on such Interest Payment Date and the portion payable on the next succeeding Interest Payment Date. The Auction Agent shall make the calculation described above not later than the close of business on each Auction Date.

Interest payments on the 2004 Series A Bonds are to be made by the Trustee to DTC as the registered owner of the 2004 Series A Bonds as of the Record Date preceding each Interest Payment Date. The 2004 Series A Bonds are to be registered in the name of Cede & Co., as nominee of DTC, which is acting as the Depository for the 2004 Series A Bonds. See "THE 2004 SERIES BONDS – Book-Entry Only System" for a description of how DTC, as owner, is expected to disburse such payments to the Beneficial Owners.

***Applicable Interest Rate.*** The rate of interest for the Initial Period shall be the rate determined upon the initial sale of the 2004 Series A Bonds. Thereafter, the rate of interest on the 2004 Series A Bonds for each subsequent Interest Period to, but not including, any Conversion Date shall be equal to the per annum rate of interest (the "Auction Rate") that results from implementation of the Auction Procedures described in Appendix III hereto unless the Auction Rate exceeds the Maximum Auction Rate (see "Carry-Over Amount" below), in which case the rate of interest on the 2004 Series A Bonds for such Interest Period shall be the Maximum Auction Rate; *provided* that if, on any Auction Date, an Auction is not held for any reason, then the rate of interest for the next succeeding Interest Period shall be equal to the Maximum Auction Rate for such Auction Period, subject to the Interest Rate Limitation

established on such Auction Date. In no event shall the interest rate on the 2004 Series A Bonds for any Auction Period exceed the Interest Rate Limitation.

Notwithstanding the foregoing, (a) if the ownership of the 2004 Series A Bonds is no longer maintained in Book-Entry Form, Auctions will be suspended and the rate of interest on the 2004 Series A Bonds, for any Interest Period commencing after the delivery of certificates representing the 2004 Series A Bonds as described above, shall equal the Maximum Auction Rate on the Business Day immediately preceding the first day of such subsequent Interest Period; or (b) if a Payment Default occurs and is continuing, Auctions will be suspended and the interest rate on the 2004 Series A Bonds for the Interest Period commencing on or immediately after such Payment Default and for each Interest Period thereafter, to and including the Interest Period, if any, during which, or commencing less than 2 Business Days after, such Payment Default is cured will equal the Overdue Rate on the first day of such Interest Period; or (c) if a proposed Conversion shall have failed, the Auctions will be conducted on the first Auction Date occurring more than 2 Business Days after the failed Conversion and the interest rate on the 2004 Series A Bonds will be determined as described below under "Failed Conversion."

Notwithstanding anything herein to the contrary, if any 2004 Series A Bonds or portion thereof have been selected for redemption during the next succeeding Interest Period, such 2004 Series A Bonds or portion thereof will not be included in the Auction preceding such redemption date and will continue to bear interest until the redemption date at the rate established for the Interest Period prior to said Auction.

**Carry-over Amount.** If the Auction Rate for any Auction Period is greater than the Maximum Auction Rate, then the interest rate applicable to the 2004 Series A Bonds for that Auction Period will be the Maximum Auction Rate. If the interest rate applicable to the 2004 Series A Bonds for any Auction Period is the Maximum Auction Rate, the Trustee shall determine the Carry-over Amount, if any, for such Auction Period, which is equal to the excess, if any, of the Auction Rate that would otherwise have applied over the Maximum Auction Rate. Such Carry-over Amount shall bear interest calculated at a rate equal to One-Month London Inter-Bank Offered Rate ("LIBOR") (as determined by the Auction Agent, provided the Trustee has received notice of One-Month LIBOR from the Auction Agent, and if the Trustee shall not have received such notice from the Auction Agent, then as determined by the Trustee) from the Interest Payment Date for the Auction Period with respect to which such Carry-over Amount was calculated, until paid or extinguished. Any payment in respect of the Carry-over Amount shall be applied, first, to any accrued interest payable thereon and, second, in reduction of such Carry-over Amount. For purposes of the Indenture, any reference to "principal" or "interest" shall not include within the meaning of such words the Carry-over Amount or any interest accrued on any such Carry-over Amount. Such Carry-over Amount shall be separately calculated for each of the 2004 Series A Bonds by the Trustee during such Auction Period in sufficient time for the Trustee to give notice to each owner of such Carry-over Amount as required in the next succeeding sentence. On the Interest Payment Date for an Interest Period with respect to which such Carry-over Amount has been calculated by the Trustee, the Trustee shall give written notice to each owner of such 2004 Series A Bonds of the Carry-over Amount applicable to such owner's Bonds which written notice may accompany the payment of interest by check made to each such owner on such Interest Payment Date or otherwise shall be mailed on such Interest Payment Date by first-class mail, postage prepaid, to each such owner at such owner's address as it appears on the registration records maintained by the Trustee. Such notice shall state, in addition to such Carry-over Amount, that, unless and until such 2004 Series A Bonds have been redeemed or have been deemed no longer outstanding under the Indenture (after which all accrued Carry-over Amount, and all accrued interest thereon, that remains unpaid shall be cancelled and no Carry-over Amount, or interest accrued thereon, shall be paid with respect to such 2004 Series A Bonds), (i) the Carry-over Amount (and interest accrued thereon calculated at a rate equal to One-Month LIBOR) shall be paid by the Trustee on 2004 Series A Bonds on the earlier of (a) the Fixed Rate Conversion Date, if any, and if then so paid, shall be paid in full or (b) the first occurring Interest Payment Date for a subsequent Interest Period if and to the extent that (1) the Eligible Carry-over Make-Up Amount (as defined in Appendix II hereto) with respect to such Interest Period is greater than zero, and (2) moneys are available pursuant to the terms of the Indenture in an amount sufficient to pay all or a portion of such Carry-over Amount (and interest accrued thereon), and (ii) interest shall accrue on the Carry-over Amount at a rate equal to One-Month LIBOR until such Carry-over Amount is paid in full or is canceled.

The Carry-over Amount (and interest accrued thereon) for the 2004 Series A Bonds shall be paid by the Trustee, if ever, on the earlier of (a) the Fixed Rate Conversion Date, if any, and if then so paid, shall be paid in full, or (b) the first occurring Interest Payment Date for a subsequent Interest Period if and to the extent that (1) the Eligible Carry-over Make-Up Amount with respect to such Interest Period is greater than zero, and (2) on such Interest Payment

Date there are sufficient moneys to pay, and available for payment of all interest due on all outstanding Bonds under the Indenture (without regard to Class) on such Interest Payment Date. Any Carry-over Amount (and any interest accrued thereon) on any of the 2004 Series A Bonds which is due and payable on an Interest Payment Date, which 2004 Series A Bonds are to be redeemed (other than by optional redemption from proceeds of a refunding) or deemed no longer outstanding under the Indenture on said Interest Payment Date, shall be paid to the owner thereof on said Interest Payment Date to the extent that moneys are available therefor in accordance with the provisions of the Indenture; provided, however, that any Carry-over Amount (and any interest accrued thereon) which is not yet due and payable on said Interest Payment Date shall be cancelled with respect to such 2004 Series A Bonds that are to be redeemed (other than by optional redemption from proceeds of a refunding) or deemed no longer outstanding under the Indenture on said Interest Payment Date and shall not be paid on any succeeding Interest Payment Date. See "SECURITY AND SOURCE OF REPAYMENT – Pledged Funds – Revenue Fund" and Appendix II "DEFINITION OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE" for a description of the circumstances which moneys would be available to pay Carry-over Amounts under the Indenture. To the extent that any portion of the Carry-over Amount (and any interest accrued thereon) remains unpaid after payment of a portion thereof, such unpaid portion shall be paid in whole or in part as required under the Sixth Supplemental Indenture until fully paid by the Trustee on the earlier of (a) the Fixed Rate Conversion Date, if any, and if then so paid, shall be paid in full, or (b) the next occurring Interest Payment Date or Dates, as necessary, for a subsequent Interest Period or Periods, if and to the extent that the conditions in the second preceding sentence are satisfied. On any Interest Payment Date on which the Trustee pays only a portion of the Carry-over Amount (and any interest accrued thereon) on the 2004 Series A Bonds, the Trustee shall give written notice in the manner set forth in the immediately preceding paragraph to the owners of such 2004 Series A Bonds receiving such partial payment of the Carry-over Amount remaining unpaid on such 2004 Series A Bonds. The Interest Payment Date in such subsequent Interest Period on which such Carry-over Amount (or any interest accrued thereon) for the 2004 Series A Bonds shall be paid, shall be determined by the Trustee in accordance with the provisions of this paragraph, and the Trustee shall make payment of the Carry-over Amount (and any interest accrued thereon) in the same manner as, and from the same account from which, it pays interest on the 2004 Series A Bonds on an Interest Payment Date. Any Carry-over Amount that remains unpaid on the date of optional redemption of the 2004 Series A Bonds from proceeds of a refunding shall be paid on the date of such redemption.

Any unpaid Carry-over Amount with respect to 2004 Series A Bonds not due and payable on the maturity or redemption date with respect to such 2004 Series A Bonds will be extinguished upon the maturity or redemption (other than by optional redemption from proceeds of a refunding) of such 2004 Series A Bonds. The Carry-over Amount will otherwise continue to accrue on the outstanding 2004 Series A Bonds. Furthermore, the Sixth Supplemental Indenture does not require that unpaid Carry-over Amounts be considered a liability for purposes of tests, if any, applicable to redemption of 2004 Series A Bonds or removal of Pledged Assets from the Indenture.

Payment of any Carry-Over Amount is not insured by the Financial Guaranty Insurance Policy.

### **Auction Participants**

***Existing Owners and Potential Owners.*** Participants in each Auction will include (i) "Existing Owners," which shall mean, with respect to and for the purpose of dealing with the Auction Agent in connection with an Auction, any Person who is (A) a Broker-Dealer listed in the books of registry at the close of business on the Business Day preceding each Auction; and (B) with respect to and for the purpose of dealing with the Broker-Dealer in connection with an Auction, a Person who is a beneficial owner of Bonds; and (ii) "Potential Owners," which shall mean any Person, including any Existing Owner, (A) who shall have executed a master purchaser's letter in the form required by the Broker-Dealer, and (B) who may be interested in acquiring 2004 Series A Bonds bearing interest at an Auction Rate (or, in the case of an Existing Owner, an additional principal amount of 2004 Series A Bonds bearing interest at an Auction Rate).

A Broker-Dealer may submit orders in Auctions for its own account. Any Broker-Dealer submitting an order for its own account in any Auction will have an advantage over other bidders in that it will have knowledge of other orders placed through it in that Auction (but it will not have knowledge of orders submitted through other Broker-Dealers, if any). As a result of the Broker-Dealer bidding, the Auction clearing rate may be lower than the rate that would have prevailed if the Broker-Dealer had not bid. A Broker-Dealer may also bid or encourage additional or revised

bidding in order to prevent what would otherwise be a failed Auction, an “all hold” Auction or an Auction clearing at a rate that the Broker-Dealer believes does not reflect the market rate for such securities at the time of the Auction.

By purchasing 2004 Series A Bonds, whether bearing interest at an Auction Rate or otherwise, each prospective purchaser of 2004 Series A Bonds or its Broker-Dealer must agree and will be deemed to have agreed: (a) to participate in Auctions on the terms set forth in the Indenture and as described in Appendix III and Appendix IV hereto, (b) to have its beneficial ownership of 2004 Series A Bonds maintained at all times in Book-Entry Form by the securities depository for the account of its Participant in DTC, which in turn will maintain records of such beneficial ownership, and (c) to authorize such Participant to disclose to the Auction Agent such information with respect to such beneficial ownership as the Auction Agent may request.

**Auction Agent.** Wells Fargo Bank, N.A., (the “Auction Agent”) has been appointed as the initial Auction Agent for the 2004 Series A Bonds. The Trustee is directed to enter into the initial Auction Agency Agreement with the Auction Agent. Any substitute Auction Agent shall be approved by the Bond Insurer and shall be (a) a bank or trust company duly organized under the laws of the United States of America or any state or territory thereof having its principal place of business in the Borough of Manhattan, the City of New York (or other location as may be approved by the Trustee and the Market Agent), and having a combined capital stock, surplus and undivided profits of at least \$15,000,000 or (b) a member of the National Association of Securities Dealers, Inc., having a capitalization of at least \$15,000,000 and, in either case, authorized by law to perform all the duties imposed upon it under the Indenture and under the Auction Agency Agreement.

The Auction Agent may at any time resign and be discharged of the duties and obligations created by the Sixth Supplemental Indenture by giving at least 90 days’ written notice to MHESO, the Trustee, the Market Agent, and the Bond Insurer. The Auction Agent may be removed at any time by the Bond Insurer or by the Trustee upon the written direction of MHESO or the owners of two-thirds in aggregate principal amount of the 2004 Series A Bonds then outstanding, each with the written consent of the Bond Insurer, and if by such owners, by an instrument signed by such owners or their attorneys and filed with the Auction Agent, MHESO and the Trustee upon at least 30 days’ notice. Neither resignation nor removal of the Auction Agent pursuant to the preceding two sentences shall be effective until and unless a successor Auction Agent has been appointed with Credit Confirmation and has accepted such appointment. Notwithstanding the foregoing, the Auction Agent may terminate the Auction Agency Agreement if, within 45 days of notifying MHESO, the Trustee and the Bond Insurer in writing that it has not received payment of any Auction Agent fee due it, the Auction Agent does not receive such payment. If the Auction Agent shall resign or be removed or dissolved, or if the property or affairs of the Auction Agent shall be taken under the control of any state or federal court or administrative body because of bankruptcy or insolvency, or for any other reason, MHESO shall appoint a successor as Auction Agent with consent of the Bond Insurer, and the Trustee shall thereupon enter into an Auction Agency Agreement approved by the Bond Insurer with such successor.

The Auction Agent is acting as agent for the Trustee and MHESO in connection with Auctions. In the absence of bad faith or negligence on its part, the Auction Agent shall not be liable for any action taken, suffered or omitted or for any error of judgment made by it in the performance of its duties under the Auction Agency Agreement and shall not be liable for any error of judgment made in good faith unless the Auction Agent shall have been negligent in ascertaining (or failing to ascertain) the pertinent facts.

**Broker-Dealer.** Existing Owners and Potential Owners may participate in Auctions only by submitting orders (in the manner described below) through a “Broker-Dealer,” including RBC Dain Rauscher Inc. (the “Broker-Dealer”) as the sole initial Broker-Dealer or any other broker or dealer (each as defined in the Securities Exchange Act of 1934, as amended), commercial bank or other entity permitted by law to perform the functions required of a Broker-Dealer, set forth in the Indenture which is approved by the Bond Insurer and (a) is a “Participant” (*i.e.*, a member of, or participant in, the Securities Depository) or an affiliate of a Participant, (b) has a capital surplus of at least \$50,000,000, (c) has been selected by MHESO with the approval of the Market Agent and (d) has entered into a Broker-Dealer Agreement with the Auction Agent that is approved by the Bond Insurer and remains effective, in which the Broker-Dealer agrees to participate in Auctions as described in the Auction Procedures, as from time to time amended or supplemented with the consent of the Bond Insurer.

**Market Agent.** Initially, RBC Dain Rauscher Inc. (the “Market Agent”) is responsible under the terms of the Market Agent Agreement relating to the 2004 Series A Bonds for determining the Quarterly Average T-Bill Rate used in determining the T-Bill Cap as a component of the Maximum Auction Rate. Under the Market Agent Agreement, and

in connection with 2004 Series A Bonds, the Market Agent shall act solely as agent of the Trustee and shall not assume any obligation or relationship of agency or trust for or with any of the Beneficial Owners.

### **Auctions**

Auctions to establish the interest rate on the 2004 Series A Bonds for each Auction Period are to be held on the related Auction Date, except as described above under "RESET AUCTION MODE SECURITIES – 2004 Series A Bonds (Taxable) – Interest – Applicable Interest Rate," by application of the Auction Procedures described in Appendix III. "Auction Date" shall mean initially September 8, 2004 and thereafter the Business Day immediately preceding the first day of each Auction Period, other than: (a) an Auction Period which commences on a Fixed Rate Conversion Date; (b) each Auction Period commencing after the ownership of 2004 Series A Bonds is no longer maintained in Book-Entry Form with DTC; (c) each Interest Period commencing after the occurrence and during the continuance of a Payment Default; or (d) any Interest Period commencing less than 2 Business Days after the cure or waiver of a Payment Default. Notwithstanding the foregoing, the Auction Date for one or more Auction Periods may be changed as described below under "Changes in Auction Periods or Auction Date — Changes in Auction Period or Periods."

The Auction Agent shall determine the Maximum Auction Rate and the All Hold Rate on each Auction Date. Upon receipt of notice from the Trustee of a failed Fixed Rate Conversion Date as described below under "Failed Conversion", the Auction Agent shall calculate the Maximum Auction Rate as of the first Business Day of the next succeeding Interest Period and give notice thereof as provided and to the parties specified in the Auction Agency Agreement. If the ownership of the 2004 Series A Bonds is no longer maintained in Book-Entry Form, the Trustee shall, with the assistance of the Market Agent, calculate the Maximum Auction Rate on the Business Day before each Interest Payment Date after the delivery of physical certificates representing 2004 Series A Bonds. If a Payment Default shall have occurred, the Trustee shall, with the assistance of the Market Agent, calculate the Overdue Rate on the first day of (a) each Interest Period commencing after the occurrence and during the continuance of such Payment Default and (b) any Interest Period commencing less than the 2 Business Days after the cure of any Payment Default. The determination by the Trustee or the Auction Agent, as the case may be, of the Maximum Auction Rate shall (in the absence of manifest error) be final and binding. If calculated or determined by the Auction Agent, the Auction Agent shall promptly advise the Trustee of the Maximum Auction Rate.

So long as ownership of the 2004 Series A Bonds is maintained in Book-Entry Form, an Existing Owner may sell, transfer or otherwise dispose of 2004 Series A Bonds only pursuant to a Bid or Sell Order (as defined in Appendix III hereto) placed in an Auction or through a Broker-Dealer, *provided* that, in the case of all transfers other than pursuant to Auctions, such Existing Owner, its Broker-Dealer or its Participant advises the Auction Agent of such transfer. Prior to a Fixed Rate Conversion Date, Auctions shall be conducted on each Auction Date, if there is an Auction Agent on such Auction Date, in the manner described in Appendix III hereto. A description of the Settlement Procedures to be used with respect to Auctions for the 2004 Series A Bonds is contained in Exhibit IV hereto.

The Market Agent shall effectuate an adjustment in the percentage used in determining the All Hold Rate, the Applicable Percentage used in determining the Maximum Auction Rate and the Applicable Percentage of the Kenny Index used to determine the Overdue Rate by delivering written notice to MHESO, the Trustee and the Auction Agent at least 10 days prior to the Auction Date on which the Market Agent desires to effect such change.

### **Changes in Auction Periods or Auction Date**

***Changes in Auction Period or Periods.*** While any of the 2004 Series A Bonds are outstanding in the Auction Rate Period, MHESO, with a Credit Confirmation, may change, upon meeting certain conditions, the length of one or more Auction Periods for the 2004 Series A Bonds. In connection with any such change, the Market Agent may change Interest Payment Dates. Any such changed Auction Period shall not be less than 7 days (unless such Auction Period falls less than 7 days prior to the final maturity of the 2004 Series A Bonds) nor more than 366 days.

The change in the length of one or more Auction Periods shall not be allowed unless Sufficient Clearing Bids (as defined in Appendix III hereto) existed at both the Auction before the date on which the notice of the proposed change was given and the Auction immediately preceding the proposed change. Such change shall take effect only if

certain requirements are met as described in the Sixth Supplemental Indenture and if such requirements are not met the succeeding Auction Period shall be a 28-day Auction Period.

***Changes in the Auction Date.*** While any of the 2004 Series A Bonds are outstanding in the Auction Rate Period, the Market Agent, in order to conform with then-current market practice with respect to similar securities, or to accommodate economic and financial factors that may affect or be relevant to the day of the week constituting an Auction Date and with the written consent of an Authorized Officer of MHESO and the Bond Insurer, may specify an earlier Auction Date (but in no event more than 5 Business Days earlier) than the Auction Date that would otherwise be determined in accordance with the definition of "Auction Date" with respect to one or more specified future Auction Periods. The Market Agent shall provide notice of any determination to specify an earlier Auction Date for one or more Auction Periods by means of a written notice delivered at least 10 days prior to the proposed changed Auction Date to the Trustee, the Auction Agent, the Bond Insurer, the Rating Agencies and MHESO.

In connection with any change in the Auction Periods or Auction Dates described above, the Auction Agent shall provide such further notice to such parties as is specified in the Auction Agency Agreement.

### **Conversion of 2004 Series A Bonds to a Fixed Rate**

MHESO may convert all or a portion of the 2004 Series A Bonds to bear interest at a Fixed Rate with the consent of, or, during an Event of Default, at the direction of, the Bond Insurer, upon notice to the Trustee, the Bond Insurer, the Remarketing Agent, initially RBC Dain Rauscher Inc. (the "Remarketing Agent"), the Auction Agent, the Market Agent and DTC not less than 28 nor more than 45 days prior to the proposed Fixed Rate Conversion Date. The Fixed Rate Conversion Date may only be on the first day of an Auction Period. On the effective date of such a conversion (the "Fixed Rate Conversion Date"), 2004 Series A Bonds converted will no longer bear interest at an Auction Rate and will be subject to mandatory tender for purchase as described in "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provisions" at a price equal to the principal amount thereof plus accrued interest, if any, thereon to the date of purchase.

### **Failed Conversion**

If a proposed Conversion fails because the Trustee and the Auction Agent shall not have timely received (i) a Credit Confirmation, (ii) MHESO's certificate stating that conditions for remarketing the 2004 Series A Bonds are in place, and (iii) MHESO's certificate authorizing the establishment of the Fixed Rate, the Auction Rate for the next succeeding Auction Period shall be determined pursuant to the Auction Procedures. If a proposed Conversion fails because the Trustee and the Auction Agent shall not have timely received (i)(a) a signed counterpart of the Conversion Supplement, (b) evidence from the Rating Agencies that a rating has been assigned to the 2004 Series A Bonds converted to a Fixed Rate and that the conversion will not cause a withdrawal or reduction of the rating, and (c) Credit Confirmation, and (ii) MHESO's certificate that all of the 2004 Series A Bonds tendered or deemed tendered have been purchased with funds provided from the remarketing of the 2004 Series A Bonds, the Auction Rate for the next succeeding Auction Period shall be the Maximum Auction Rate determined as of such Auction Date. After any such failed conversion the 2004 Series A Bonds subject to the failed conversion shall remain outstanding as RAMS.

## ***2004 Series B Bonds (Tax Exempt)***

### **General**

The 2004 Series B Bonds are being issued as RAMS. The 2004 Series B Bonds are dated and mature as set forth on the cover of this Official Statement and as described herein. Certain capitalized terms used herein with respect to the 2004 Series B Bonds are defined in "DEFINITION OF CERTAIN TERMS AND SUMMARY OF INDENTURE," Appendix II to this Official Statement. The following discussion of interest on the 2004 Series B Bonds relates to the 2004 Series B Bonds while outstanding as RAMS, unless otherwise provided.

## **Interest**

***Interest Payments.*** While the 2004 Series B Bonds bear interest at an Auction Rate, interest accrued on the 2004 Series B Bonds shall be computed on the basis of a year of 360 days for the number of days actually elapsed. The 2004 Series B Bonds shall bear interest from the date thereof payable on each Interest Payment Date.

An "*Interest Payment Date*" means for the 2004 Series B Bonds (a) each May 1 and November 1, commencing November 1, 2004, except as changed pursuant to the Seventh Supplemental Indenture; (b) any day on which the 2004 Series B Bonds are subject to mandatory tender for purchase or redemption in whole pursuant to the Indenture; and (c) the Stated Maturity Date of the 2004 Series B Bonds.

The amount of interest distributable to holders of 2004 Series B Bonds bearing interest at an Auction Rate in respect of each \$100,000 in principal amount thereof for any Interest Period or part thereof shall be calculated by the Trustee by applying the Bond Interest Rate for such Interest Period or part thereof, to the principal amount of \$100,000, multiplying such product by the actual number of days in the Interest Period or part thereof, dividing by 360, and, if necessary, truncating the resultant figure to the nearest cent. In the event an Interest Payment Date occurs in any Interest Period on a day other than the first day of such Interest Period, the Auction Agent, after confirming the calculation required above, shall calculate the portion of the interest amount payable on such Interest Payment Date and the portion payable on the next succeeding Interest Payment Date. The Auction Agent shall make the calculation described above not later than the close of business on each Auction Date.

Interest payments on the 2004 Series B Bonds are to be made by the Trustee to DTC as the registered owner of the 2004 Series B Bonds as of the Record Date preceding each Interest Payment Date. The 2004 Series B Bonds are to be registered in the name of Cede & Co., as nominee of DTC, which is acting as the Depository for the 2004 Series B Bonds. See "THE 2004 SERIES BONDS – Book-Entry Only System" for a description of how DTC, as owner, is expected to disburse such payments to the Beneficial Owners.

***Applicable Interest Rate.*** The rates of interest for the Initial Period shall be the rate determined upon the initial sale of the 2004 Series B Bonds. Thereafter, the rate of interest on the 2004 Series B Bonds for each subsequent Interest Period to, but not including, any Conversion Date shall be equal to the per annum rate of interest (the "Auction Rate") that results from implementation of the Auction Procedures described in Appendix III hereto unless the Auction Rate exceeds the Maximum Auction Rate, in which case the rate of interest on the 2004 Series B Bonds for such Interest Period shall be the Maximum Auction Rate; *provided* that if, on any Auction Date, an Auction is not held for any reason, then the rate of interest for the next succeeding Interest Period shall be equal to the Maximum Auction Rate for such Auction Period, subject to the Interest Rate Limitation established on such Auction Date. In no event shall the interest rate on the 2004 Series B Bonds exceed the Interest Rate Limitation.

Notwithstanding the foregoing, (a) if the ownership of the 2004 Series B Bonds is no longer maintained in Book-Entry Form, Auctions will be suspended and the rate of interest on the 2004 Series B Bonds, for any Interest Period commencing after the delivery of certificates representing the 2004 Series B Bonds as described above, shall equal the Maximum Auction Rate on the Business Day immediately preceding the first day of such subsequent Interest Period; or (b) if a Payment Default occurs and is continuing, Auctions will be suspended and the interest rate on the 2004 Series B Bonds for the Interest Period commencing on or immediately after such Payment Default and for each Interest Period thereafter to and including the Interest Period, if any, during which, or commencing less than two Business Days after, such Payment Default is cured will equal the Overdue Rate on the first day of such Interest Period; or (c) if a proposed Conversion shall have failed, Auctions will be conducted on the first Auction Date occurring more than two Business Days after the failed Conversion and the interest rate on the 2004 Series B Bonds will be determined as described below under "Failed Conversion."

Notwithstanding anything herein to the contrary, if any 2004 Series B Bonds or portion thereof have been selected for redemption during the next succeeding Interest Period, such 2004 Series B Bonds or portion thereof will not be included in the Auction preceding such redemption date and will continue to bear interest until the redemption date at the rate established for the Interest Period prior to said Auction.

## **Auction Participants**

***Existing Owners and Potential Owners.*** Participants in each Auction will include (i) "Existing Owners," which shall mean, with respect to and for the purpose of dealing with the Auction Agent in connection with an Auction, any Person who is (A) a Broker-Dealer listed in the books of registry at the close of business on the Business Day preceding each Auction; and (B) with respect to and for the purpose of dealing with the Broker-Dealer in connection with an Auction, a Person who is a beneficial owner of Bonds; and (ii) "Potential Owners," which shall mean any Person, including any Existing Owner, (A) who shall have executed a master purchaser's letter in the form required by the Broker-Dealer, and (B) who may be interested in acquiring 2004 Series B Bonds bearing interest at an Auction Rate (or, in the case of an Existing Owner, an additional principal amount of 2004 Series B Bonds bearing interest at an Auction Rate).

A Broker-Dealer may submit orders in Auctions for its own account. Any Broker-Dealer submitting an order for its own account in any Auction will have an advantage over other bidders in that it will have knowledge of other orders placed through it in that Auction (but it will not have knowledge of orders submitted through other Broker-Dealers, if any). As a result of the Broker-Dealer bidding, the Auction clearing rate may be lower than the rate that would have prevailed if the Broker-Dealer had not bid. A Broker-Dealer may also bid or encourage additional or revised bidding in order to prevent what would otherwise be a failed Auction, an "all hold" Auction or an Auction clearing at a rate that the Broker-Dealer believes does not reflect the market rate for such securities at the time of the Auction.

By purchasing 2004 Series B Bonds, whether bearing interest at an Auction Rate or otherwise, each prospective purchaser of 2004 Series B Bonds or its Broker-Dealer must agree and will be deemed to have agreed: (a) to participate in Auctions on the terms set forth in the Indenture and as described in Appendix III and Appendix IV hereto, (b) to have its beneficial ownership of 2004 Series B Bonds maintained at all times in Book-Entry Form by the securities depository for the account of its Participant in DTC, which in turn will maintain records of such beneficial ownership, and (c) to authorize such Participant to disclose to the Auction Agent such information with respect to such beneficial ownership as the Auction Agent may request.

***Auction Agent.*** Wells Fargo Bank, N.A. has been appointed as the initial Auction Agent for the 2004 Series B Bonds. The Trustee is directed to enter into the initial Auction Agency Agreement with the Auction Agent. Any substitute Auction Agent shall be approved by the Bond Insurer and shall be (a) a bank or trust company duly organized under the laws of the United States of America or any state or territory thereof having its principal place of business in the Borough of Manhattan, the City of New York (or such other location as may be approved by the Trustee and the Market Agent), and having a combined capital stock, surplus and undivided profits of at least \$15,000,000 or (b) a member of the National Association of Securities Dealers, Inc., having a capitalization of at least \$15,000,000 and, in either case, authorized by law to perform all the duties imposed upon it under the Indenture and under the Auction Agency Agreement.

The Auction Agent may at any time resign and be discharged of the duties and obligations created by the Seventh Supplemental Indenture by giving at least 90 days' written notice to MHESO, the Trustee, the Market Agent, and the Bond Insurer. The Auction Agent may be removed at any time by the Bond Insurer or by the Trustee upon the written direction of MHESO or the owners of two-thirds in aggregate principal amount of the 2004 Series B Bonds then outstanding, each with the written consent of the Bond Insurer, and if by such owners, by an instrument signed by such owners or their attorneys and filed with the Auction Agent, MHESO and the Trustee upon at least 30 days' notice. Neither resignation nor removal of the Auction Agent pursuant to the preceding two sentences shall be effective until and unless a successor Auction Agent has been appointed with Credit Confirmation and has accepted such appointment. Notwithstanding the foregoing, the Auction Agent may terminate the Auction Agency Agreement if, within 45 days of notifying MHESO, the Trustee and the Bond Insurer in writing that it has not received payment of any Auction Agent fee due it, the Auction Agent does not receive such payment. If the Auction Agent shall resign or be removed or dissolved, or if the property or affairs of the Auction Agent shall be taken under the control of any state or federal court or administrative body because of bankruptcy or insolvency, or for any other reason, MHESO shall appoint a successor as Auction Agent with consent of the Bond Insurer, and the Trustee shall thereupon enter into an Auction Agency Agreement approved by the Bond Insurer with such successor.

The Auction Agent is acting as agent for the Trustee and MHESO in connection with Auctions. In the absence of bad faith or negligence on its part, the Auction Agent shall not be liable for any action taken, suffered or omitted or for any error of judgment made by it in the performance of its duties under the Auction Agency Agreement and shall



not be liable for any error of judgment made in good faith unless the Auction Agent shall have been negligent in ascertaining (or failing to ascertain) the pertinent facts.

**Broker-Dealer.** Existing Owners and Potential Owners may participate in Auctions only by submitting orders (in the manner described below) through a "Broker-Dealer," including RBC Dain Rauscher Inc. as the sole initial Broker-Dealer or any other broker or dealer (each as defined in the Securities Exchange Act of 1934, as amended), commercial bank or other entity permitted by law to perform the functions required of a Broker-Dealer, set forth in the Indenture which is approved by the Bond Insurer and (a) is a "Participant" (*i.e.*, a member of, or participant in, the Securities Depository) or an affiliate of a Participant, (b) has a capital surplus of at least \$15,000,000, (c) has been selected by MHESO with the approval of the Market Agent and (d) has entered into a Broker-Dealer Agreement with the Auction Agent that is approved by the Bond Insurer and remains effective, in which the Broker-Dealer agrees to participate in Auctions as described in the Auction Procedures, as from time to time amended or supplemented with the consent of the Bond Insurer.

**Market Agent.** Initially the Market Agent is responsible under the terms of the Market Agent Agreement relating to the 2004 Series B Bonds for (i) adjusting the percentage used in the All Hold Rate, the Applicable Percentage used in determining the Maximum Auction Rate and the percentage of the After-Tax Equivalent Rate or the Kenny Index used to determine the Overdue Rate, (ii) determining the Kenny Index, and (iii) determining the Quarterly Average T-Bill Rate used in determining the T-Bill Cap as a component of the Maximum Auction Rate. See "Adjustments in Percentages for 2004 Series B Bonds" below. Under the Market Agent Agreement, and in connection with RAMS, the Market Agent shall act solely as agent of the Trustee and shall not assume any obligation or relationship of agency or trust for or with any of the Beneficial Owners.

## **Auctions**

Auctions to establish the interest rate on the 2004 Series B Bonds for each Auction Period are to be held on the related Auction Date, except as described above under "RESET AUCTION MODE SECURITIES – 2004 Series B Bonds (Tax Exempt) – Interest – Applicable Interest Rate," by application of the Auction Procedures described in Appendix III. "Auction Date" shall mean initially September 1, 2004 and thereafter the Business Day immediately preceding the first day of each Auction Period, other than: (a) an Auction Period which commences on a Conversion Date; (b) each Auction Period commencing after the ownership of the 2004 Series B Bonds is no longer maintained in Book-Entry Form by DTC; (c) each Interest Period commencing after the occurrence and during the continuance of a Payment Default; or (d) any Interest Period commencing less than 2 Business Days after the cure or waiver of a Payment Default. Notwithstanding the foregoing, the Auction Date for one or more Auction Periods may be changed as described below under "Changes in Auction Periods or Auction Date — Changes in Auction Period or Periods."

The Auction Agent shall determine the Maximum Auction Rate and the All Hold Rate on each Auction Date. Upon receipt of notice from the Trustee of a failed Conversion Date as described below under "Failed Conversion", the Auction Agent shall not hold an Auction on such Auction Date but shall calculate the Maximum Auction Rate as of the first Business Day of the next succeeding Interest Period and give notice thereof as provided and to the parties specified in the Auction Agency Agreement. If the ownership of the 2004 Series B Bonds is no longer maintained in Book-Entry Form, Auctions will be suspended and the Trustee shall, with the assistance of the Market Agent, calculate the Maximum Auction Rate on the Business Day immediately preceding the first day of each Interest Period commencing after delivery of certificates representing such 2004 Series B Bonds. If a Payment Default shall have occurred, the Trustee shall, with the assistance of the Market Agent, calculate the Overdue Rate on the first day of (a) each Interest Period commencing after the occurrence and during the continuance of such Payment Default and (b) any Interest Period commencing less than the 2 Business Days after the cure of any Payment Default. The determination by the Trustee or the Auction Agent, as the case may be, of the Maximum Auction Rate shall (in the absence of manifest error) be final and binding. If calculated or determined by the Auction Agent, the Auction Agent shall promptly advise the Trustee of the Maximum Auction Rate.

So long as ownership of the 2004 Series B Bonds is maintained in Book-Entry Form, an Existing Owner may sell, transfer or otherwise dispose of 2004 Series B Bonds only pursuant to a Bid or Sell Order (as defined in Appendix III hereto) placed in an Auction or through a Broker-Dealer, *provided* that, in the case of all transfers other than pursuant to Auctions, such Existing Owner, its Broker-Dealer or its Participant advises the Auction Agent of such transfer. Prior to a Fixed Rate Conversion Date, Auctions shall be conducted on each Auction Date, if there is an Auction Agent on such

Auction Date, in the manner described in Appendix III hereto. A description of the Settlement Procedures to be used with respect to Auctions for the 2004 Series B Bonds is contained in Exhibit IV hereto.

#### **Adjustment of Percentages for 2004 Series B Bonds**

With consent of the Bond Insurer, the Market Agent shall adjust the percentage used in determining the All Hold Rate, the Applicable Percentage used in determining the Maximum Auction Rate and the Applicable Percentage of the Kenny Index used in determining the Overdue Rate, if any such adjustment is necessary, in the judgment of the Market Agent, to reflect any Change of Preference Law such that 2004 Series B Bonds paying the Maximum Auction Rate, the All Hold Rate or the Overdue Rate shall have equal market values before and after such Change of Preference Law. Prior to any such adjustment, MHESO shall give notice thereof to each Rating Agency and the Credit Provider, and no such adjustment shall be made unless such adjustment will not adversely affect the Rating on any of the 2004 Series B Bonds. In making any such adjustment, the Market Agent shall take the following factors, as in existence both before and after such Change of Preference Law, into account: (i) short-term taxable and tax-exempt market rates and indices of such short-term rates; (ii) the market supply and demand for short-term tax-exempt securities; (iii) yield curves for short-term and long-term tax-exempt securities or obligations having a credit rating that is comparable to the 2004 Series B Bonds; (iv) general economic conditions; and (v) economic and financial factors present in the securities industry that may affect or that may be relevant to the 2004 Series B Bonds.

The Market Agent shall effectuate an adjustment in the percentage used in determining the All Hold Rate, the Applicable Percentage used in determining the Maximum Auction Rate and the Applicable Percentage of the Kenny Index used to determine the Overdue Rate by delivering written notice to MHESO, the Trustee and the Auction Agent at least 10 days prior to the Auction Date on which the Market Agent desires to effect such change, accompanied by an Opinion of Bond Counsel to the effect that such adjustment will not adversely affect the exclusion of interest on the 2004 Series B Bonds from gross income for federal income tax purposes.

#### **Changes in Auction Periods or Auction Date**

***Changes in Auction Period or Periods.*** While any of the 2004 Series B Bonds are outstanding in the Auction Rate Period, MHESO, with a Credit Confirmation, may change, upon meeting certain conditions, the length of one or more Auction Periods for the 2004 Series B Bonds. In connection with any such change, the Market Agent may change Interest Payment Dates. Any such changed Auction Period shall not be less than 7 days (unless such Auction Period falls less than 7 days prior to the final maturity of the 2004 Series B Bonds) nor more than 366 days.

The change in the length of one or more Auction Periods shall not be allowed unless Sufficient Clearing Bids (as defined in Appendix III hereto) existed at both the Auction before the date on which the notice of the proposed change was given and the Auction immediately preceding the proposed change. Such change shall take effect only if certain requirements are met as described in the Seventh Supplemental Indenture and if such requirements are not met the succeeding Auction Period shall be a 35-day Auction Period.

***Changes in the Auction Date.*** While any of the 2004 Series B Bonds are outstanding in the Auction Rate Period, the Market Agent, in order to conform with then-current market practice with respect to similar securities, or to accommodate economic and financial factors that may affect or be relevant to the day of the week constituting an Auction Date and with the written consent of an Authorized Officer of MHESO and the Bond Insurer, may specify an earlier Auction Date (but in no event more than 5 Business Days earlier) than the Auction Date that would otherwise be determined in accordance with the definition of "Auction Date" with respect to one or more specified future Auction Periods. The Market Agent shall provide notice of any determination to specify an earlier Auction Date for one or more Auction Periods by means of a written notice delivered at least 10 days prior to the proposed changed Auction Date to the Trustee, the Auction Agent, the Bond Insurer, the Rating Agencies and MHESO.

In connection with any change in the Auction Periods or Auction Dates described above, the Auction Agent shall provide such further notice to such parties as is specified in the Auction Agency Agreement.

### **Conversion of 2004 Series B Bonds to an Adjustable Rate**

MHESO may convert all of the 2004 Series B Bonds from an Auction Rate to a different Adjustable Rate, with the consent of or, during an Event of Default, at the direction of the Bond Insurer, upon notice to the Trustee, the Rating Agencies, the Remarketing Agent, the Auction Agent, the Market Agent, the Credit Provider and DTC, not less than 30 days prior to the proposed effective date of the Change in the Interest Rate Mode. Such a Change in the Interest Rate Mode may only be effected with the consent of the Credit Provider on the first day of an Auction Period. On the effective date of any such Change in the Interest Rate Mode (the "Adjustable Rate Conversion Date"), the Bonds shall no longer bear interest at an Auction Rate and will be subject to mandatory tender for purchase as described in "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provisions" at a price equal to the principal amount thereof plus accrued interest, if any, thereon to the date of purchase.

### **Conversion of 2004 Series B Bonds to a Fixed Rate**

MHESO, with the consent of the Credit Provider, may convert all or any portion of the 2004 Series B Bonds outstanding to bear interest at a Fixed Rate with the consent of the Bond Insurer, upon notice to the Trustee, the Bond Insurer, the Remarketing Agent, the Auction Agent, the Market Agent and DTC not less than 28 nor more than 45 days prior to the proposed Fixed Rate Conversion Date. The Fixed Rate Conversion Date may only be on the first day of an Auction Period. On the effective date of such a conversion (the "Fixed Rate Conversion Date", which, along with an Adjustable Rate Conversion Date, is a "Conversion Date"), 2004 Series B Bonds converted will no longer bear interest at an Auction Rate and will be subject to mandatory tender for purchase as described in "THE 2004 SERIES BONDS – Redemption and Mandatory Tender Provision" at a price equal to the principal amount thereof plus accrued interest, if any, thereon to the date of purchase.

### **Failed Conversion**

If a Conversion fails, depending on the type of conversion and the reason or reasons for the failure, pursuant to the Seventh Supplemental Indenture (i) the Auction Rate for the succeeding Auction Period may be determined by Auction Procedures; or (ii) the Auction Rate for the succeeding Period may be equal to Maximum Auction Rate as determined on such Auction Date.

After any such failed conversion, the 2004 Series B Bonds subject to the failed conversion shall remain outstanding as RAMS.

MHESO shall not be allowed to effect a Change in the Interest Rate Mode or a conversion to the Fixed Rate upon the occurrence and continuation of an Event of Default pursuant to the Indenture unless consented to or directed by the Credit Provider.

## **SECURITY AND SOURCE OF REPAYMENT**

### ***Limited Obligations***

The 2004 Series Bonds and interest thereon do not constitute or give rise to a pecuniary liability of the State, or a general or moral obligation or a pledge of the full faith and credit of MHESO, the State or any agency or political subdivision thereof. Neither the faith nor credit nor the taxing power of the State or any agency or political subdivision thereof (including MHESO) is pledged to the payment of the principal of or the interest on the 2004 Series Bonds. MHESO has no taxing power.

### ***Cash Flow Projections***

MHESO expects that the Revenues to be derived from the Student Loans and other amounts on deposit under the Indenture should be sufficient to pay the principal of and interest on the 2004 Series Bonds when due. This

expectation is based upon an analysis of cash flow projections, using assumptions which MHESO believes are reasonable, regarding (i) the characteristics and expected performance of the Student Loans to be deposited to the Student Loan Fund, (ii) amounts to be deposited in the Debt Service Reserve Fund and the Capitalized Interest Subaccount of the Revenue Fund, if any, together with the earnings thereon, and (iii) the occurrence of certain future events and conditions, as described below (the "Cash Flow Projections"). See Appendix VII, "Loan Portfolio Composition," for a more complete description of the Student Loans to be deposited to the Student Loan Fund.

***Defaulted Student Loans.*** If the Senior Asset Coverage Ratio falls below 101%, the Indenture requires MHESO to purchase or replace Defaulted Student Loans pledged under the Indenture with a like amount of non-delinquent Student Loans, cash, Investment Securities or any combination thereof (see Appendix II hereto, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE – SUMMARIES OF DOCUMENTS – THE SIXTH AND SEVENTH SUPPLEMENTAL INDENTURES – Deposits into Funds and Accounts; Disposition of Proceeds of the Sale of the 2004 Series Bonds; and Use and Disbursements of Funds – Purchase of Defaulted Student Loans"). The Cash Flow Projections performed in connection with the issuance of the 2004 Series Bonds demonstrate that funds available under the Indenture should be sufficient to pay the principal of and interest on the Bonds (including the 2004 Series Bonds) without the purchase or replacement of Defaulted Student Loans pledged under the Indenture from other sources.

***Program Expenses.*** Under the Indenture, MHESO is obligated to pay certain Program Expenses from sources other than the Trust Estate. If MHESO fails to do so, the Trustee will be required to pay such Program Expenses (subject to certain limitations contained in the related Supplemental Indenture) from amounts in the related accounts of the Revenue Fund, the Surplus Fund and the Acquisition Fund prior to the use of such amounts to pay principal of or interest on the 2004 Series Bonds. See "Pledged Funds – Revenue Fund" below. Such Program Expenses include, but are not limited to, fees and expenses of any Bond Insurer, any Servicer, any Trustee, any Auction Agent and any Broker-Dealer. The Cash Flow Projections assume that MHESO pays certain such expenses from its Loan Capital Fund, and do not assume that any such expenses are paid from the Revenues to be received under the Indenture.

### ***Pledged Funds***

The 2004 Series Bonds are secured by MHESO's pledge to the Trustee under the Indenture of (i) all Student Loans, including agreements and notes evidencing the same or extensions or renewals thereof; (ii) all proceeds of the 2004 Series Bonds, Revenues and any other amounts contained in the Funds and Accounts until their use or release from the Funds and Accounts, including amounts in the Debt Service Reserve Fund, which may take the form of moneys, securities, accounts, chattel paper, instruments, and general intangibles; and (iii) all rights of MHESO in and to the Servicing Agreement as it relates to Student Loans held by the Trustee under the Indenture. See Appendix II, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE."

***Revenue Fund.*** The Revenue Fund shall receive amounts described in the Supplemental Indentures, any other amounts deposited thereto on MHESO's order, and all Revenues, which include all payments, proceeds, charges, and other income received by MHESO on account of any Student Loan and all interest earned or gain realized from the investment of money in the Funds and Accounts (with certain exceptions provided in the Indenture). The Revenue Fund shall also receive all payments of principal and interest, if any, together with any tuition refunds, repurchase payments from sellers, funds transferred to the Trustee from the Servicer's or Servicers' separate bank accounts maintained pursuant to any Servicing Agreement, insurance and guaranty payments and proceeds from the sale of Student Loans.

On each Monthly Payment Date, money in the respective series accounts of the Revenue Fund shall be applied to the respective series according to the terms of the Indenture in the following order of priority, to pay:

1. amounts necessary (if any) to maintain the Rebate Fund and the Excess Interest Fund at their respective required levels;
2. any otherwise unpaid Servicer fees and expenses;
3. any otherwise unpaid Trustee fees and expenses;

With regard to the Class I Bonds (including the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds):

4. any otherwise unpaid Credit Provider or Liquidity Provider premiums or fees if MHESO has not certified that such premiums or fees have been paid from a source other than the Trust Estate;
5. any otherwise unpaid Indenture Agent (other than the Trustee) fees and expenses if MHESO has not certified that such fees or expenses have been paid from a source other than the Trust Estate;
6. any amount due pursuant to any Interest Rate Exchange Agreement;
7. interest on the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds and any other Class I Bonds;
8. principal of the 2004 Series Bonds, the 2003 Series Bonds, the 2002 Series Bonds and the 1999 Series Bonds and any other Class I Bonds;
9. any amount necessary to reimburse a Credit Provider for claims or draws on its Credit Facility to pay principal of and interest on Class I Bonds;
10. to the extent other moneys are insufficient therefor, an amount sufficient to pay the Purchase Price of any Class I Bond on the related Purchase Date;
11. any amount necessary to reimburse a Liquidity Provider for draws on its Liquidity Facility to pay the Purchase Price of any Class I Bond, together with any required interest thereon;
12. any other amounts due to a Credit Provider or Indenture Agent (other than the Trustee) if MHESO has not certified that such amounts have been paid from a source other than the Trust Estate;

Steps (4) through (12) above will repeat for each Class of Bonds subordinate to the Class I Bonds in descending order of priority.

13. any amount necessary to maintain the Debt Service Reserve Fund at the Debt Service Reserve Requirement;
14. any Carry-over Amount payable (which shall be paid (i) pursuant to this clause or (ii) from moneys in the Surplus Fund after taking into account all other amounts payable therefrom on such Interest Payment Date), which shall be paid first to the Class I Bonds and then to each Class of Bonds subordinate to the Class I Bonds in order of their priority;
15. at MHESO's written direction, to purchase or make Student Loans with any remaining money or portion thereof; and
16. to the Surplus Fund any remaining balance.

In the event amounts are payable to more than one Person pursuant to any of the preceding clauses, and the money available is insufficient to pay all such amounts, the available money shall be applied pro rata to the payment of each Person based upon the amount payable thereto.

***Debt Service Reserve Fund.*** The Debt Service Reserve Requirement is an amount equal to the aggregate of amounts specified in each and every Supplemental Indenture authorizing the issuance of a series of bonds as the amount required to be deposited in the Debt Service Reserve Fund with respect to such series of Bonds and approved by the Credit Provider, if any, with respect to such series of Bonds. The Debt Service Reserve Requirement for each series of the 2004 Series Bonds is an amount equal to the greater of (a) two percent (2%) of the principal amount of such series outstanding from time to time or (b) that amount which is in the same proportion to \$250,000 as the principal amount of such series outstanding is to the principal amount of all Bonds outstanding. On the Closing Date the 2004 Series A Bond Debt Service Reserve Requirement will be equal to \$1,340,000 and the 2004 Series B Bond Debt Service Reserve Requirement will be equal to \$1,770,000 and both series will be satisfied with a deposit from proceeds of the 2004 Series A Bonds.

Amounts in the Debt Service Reserve Fund will be invested in Investment Securities (as defined in the Indenture).

Amounts held in the Debt Service Reserve Fund shall be applied as necessary to make up on a Bond Payment Date any deficiency in the amounts to pay Bond principal or interest, but only after application of moneys from, in order, the Revenue Fund, Surplus Fund, and Acquisition Fund. To the extent moneys on deposit in the Debt Service Reserve Fund exceed the Debt Service Reserve Requirement, as required in the Supplemental Indentures, MHESO shall direct the Trustee to transfer the excess and all earnings thereon to the Surplus Fund. The Debt Service Reserve Fund may also be used to pay final installments of principal of and interest on the Bonds. On or before each Monthly Payment Date (or any other date at MHESO's request), the Trustee shall value the Debt Service Reserve Fund to determine whether the Debt Service Reserve Requirement has been satisfied; shortfalls shall be replenished from amounts on deposit in the Revenue Fund as described above in "Revenue Fund." If the Revenue Fund has insufficient funds to so replenish the Debt Service Reserve Fund, moneys available for that purpose in the Surplus Fund may be used. See also Appendix II hereto, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE."

**Redemption Funds.** On the Closing Date, \$68,500,000 will be deposited in the 1992, 1993 and 1994 Redemption Funds, in the individual amounts of \$30,000,000, \$20,000,000, and \$18,500,000, respectively, from the net proceeds of the 2004 Series B Bonds, upon receipt of a like principal amount of Student Loans previously financed with proceeds of such bonds, or, in the case of the Series 1993 Bonds, receipt of approximately \$18,600,000 principal amount of Student Loans previously financed with proceeds of the Series 1993 Bonds and approximately \$1,400,000 (in cash and Student Loans) remaining in the Series 1993 Debt Service Reserve Fund, all of which Student Loans and cash will be deposited in the 2004 Series B Account of the Student Loan Fund and the 2004 Series B Account of the Acquisition Fund, respectively. The Series 1992 Bonds, the Series 1993 Bonds and the Series 1994B Bonds will be redeemed on September 1, 2004 at the option of MHESO.

**Acquisition Fund.** On the Closing Date, after making the deposits described above to the related accounts of the Revenue Fund, the Debt Service Reserve Fund, and the Redemption Funds, remaining net proceeds from the sale of the 2004 Series Bonds in the amount of \$63,890,000 will be deposited to the 2004 Series A Account of the Acquisition Fund and the amount of \$20,000,000 will be deposited to the 2004 Series B Account of the Acquisition Fund. Such moneys shall be used within 45 days of the Closing Date to purchase, originate or refinance Student Loans.

**Student Loan Fund.** All Student Loans transferred to the Trustee by MHESO, including those financed or refinanced with proceeds from the 2004 Series Bonds or acquired from any Revenues under the Indenture, will be deposited to the related accounts of the Student Loan Fund. The Student Loan Fund shall hold only Student Loans and no other assets of any kind whatsoever.

**Financial Covenants.** Pursuant to the terms of the Supplemental Indentures, MHESO has entered into the following financial covenants:

- (a) Within 45 days after each March 31, June 30, September 30 and December 31, MHESO shall maintain with the State Treasurer cash in an amount equal to one percent (1%) of all SELF II and SELF III Student Loans outstanding.
- (b) MHESO shall not permit its Tangible Net Worth at any time to be less than \$100,000,000 (Tangible Net Worth means MHESO's aggregate net worth, determined in accordance with GAAP, less the book value of all of MHESO's assets that would be treated as intangibles under GAAP).
- (c) MHESO shall not permit the ratio of (1) the sum of (i) 33% of any of MHESO's bonds as to which no expenses are expected to be paid from MHESO's Loan Capital Fund nor is there an expectation that defaulted student loans will be repurchased from funds in the Loan Capital Fund or replaced with loans from the Loan Capital Fund, (ii) 66% of any of MHESO's bonds as to which only (A) expenses of the bonds are expected to be paid from the Loan Capital Fund or (B) repurchase or replacement of student loans which are defaulted student loans are from funds or loans in the Loan Capital Fund plus (iii) 100% of any of MHESO's bonds as to which expenses or any other amounts are expected to be paid from MHESO's Loan Capital Fund divided by (2) Tangible Net Worth, to be greater than four and one half (4.5); provided however, that the percentage referred to in clause (ii) above shall be adjusted as follows: as of the most recent quarterly calculation, if the Senior Asset Coverage Ratio is 101% or lower, the percentage shall be 100%, if the Senior Asset Coverage Ratio is 101.5% or lower

but greater than 101%, the percentage shall be 90% and if the Senior Asset Coverage Ratio is 102% or lower but greater than 101.5%, the percentage shall be 80%.

- (d) MHESO shall maintain \$3,400,000 in cash and Investment Securities in its Loan Capital Fund which mature in less than one (1) year, provided that after December 31, 2004, MHESO shall maintain \$3,200,000 in cash and Investment Securities in its Loan Capital Fund which mature in less than one (1) year.
- (e) MHESO shall not permit its Tangible Net Worth less any loans to the State to be less than \$290,000,000 on or after June 30, 2004, \$305,000,000 on or after June 30, 2005, \$325,000,000 on or after June 30, 2006, \$340,000,000 on or after June 30, 2007, \$360,000,000 on or after June 30, 2008, \$380,000,000 on or after June 30, 2009, \$400,000,000 on or after June 30, 2010, \$425,000,000 on or after June 30, 2011, \$450,000,000 on or after June 30, 2012, \$475,000,000 on or after June 30, 2013, \$500,000,000 on or after June 30, 2014 and thereafter until no 2004 Series Bonds are outstanding. The failure of MHESO to comply with this covenant shall not constitute an Event of Default under the Sixth or Seventh Supplemental Indentures unless MHESO has withdrawn moneys from the Loan Capital Fund for a purpose other than to pay expenses related to the administration of loans made by MHESO, to make loans under the Supplemental Student Loan Program or to repurchase defaulted student loans held under an indenture.
- (f) MHESO shall not issue any bonds, notes or other obligations (including Additional Bonds) (the "New Bonds") unless at the time of such issuance MHESO is not in default under the Indenture, any reimbursement agreement between MHESO and MBIA, or with respect to any bonds, notes or other obligations of MHESO issued under any other indenture and:
  - (1) the Credit Provider issues a Credit Facility with respect to such New Bonds; or
  - (2) if the New Bonds are not subject to bond insurance or other form of credit enhancement, MHESO provides to the Trustee written evidence from each rating agency rating such New Bonds that such New Bonds shall be rated in one of the three highest Rating Categories; and
  - (3) as to any bonds, notes or other obligations of MHESO which are currently outstanding and not secured by bond insurance or other form of credit enhancement ("Unenhanced Bonds"), MHESO provides to the Trustee written evidence from each rating agency then rating such Unenhanced Bonds that such Unenhanced Bonds shall be rated in one of the three highest Rating Categories upon issuance of such New Bonds; and
  - (4) as to any bonds, notes or other obligations of MHESO which are currently outstanding and secured by a Credit Facility issued by the Credit Provider ("Enhanced Bonds"), the Credit Provider receives evidence from each rating agency then rating such Enhanced Bonds that such Enhanced Bonds, without the benefit of any such Credit Facility, would be rated in one of the three highest Rating Categories upon issuance of such New Bonds.
- (g) MHESO shall not issue any bonds, notes or other obligations, other than Additional Bonds issued under the Indenture, which will have a greater claim on the assets of the Loan Capital Fund than the claim created under the Indenture.
- (h) MHESO shall notify the Credit Provider of an event of default with respect to any bonds, notes or other obligations issued by MHESO including an event of default with respect to any bonds, notes or other obligations not issued under the Indenture.

Notwithstanding the foregoing, MHESO's Loan Capital Fund is not pledged under the Indenture as security for the 2004 Series Bonds. Nevertheless, the Loan Capital Fund is expected to be used to pay certain expenses, including costs of issuance of the 2004 Series Bonds and certain Program Expenses, and, under certain circumstances, to purchase or replace Defaulted Student Loans.

## **BOND INSURANCE**

The following information has been furnished by MBIA Insurance Corporation for use in this Official Statement. Reference is made to Appendix VIII for a specimen of MBIA's policy.

***The MBIA Insurance Corporation Insurance Policy.*** MBIA's policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of MHESO to the Paying Agent or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest, but not any Carry-over Amount on the 2004 Series A Bonds, on the 2004 Series Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by MBIA's policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the 2004 Series Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

MBIA's policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any 2004 Series Bonds. MBIA's policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of 2004 Series Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. MBIA's policy also does not insure against nonpayment of principal of or interest on the 2004 Series Bonds resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the 2004 Series Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of a 2004 Series Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such 2004 Series Bonds or presentment of such other proof of ownership of the 2004 Series Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the 2004 Series Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the 2004 Series Bonds in any legal proceeding related to payment of insured amounts on the 2004 Series Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the insured amounts due on such 2004 Series Bonds, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

***MBIA.*** MBIA Insurance Corporation ("MBIA") is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA has three branches, one in the Republic of France, one in the Republic of Singapore and one in the Kingdom of Spain. New York has laws prescribing minimum capital requirements, limiting classes and concentrations of investments and requiring the approval of policy rates and forms. State laws also regulate the amount of both the aggregate and individual risks that may be insured, the payment of dividends by MBIA, changes in control and transactions among affiliates. Additionally, MBIA is required to maintain contingency reserves on its liabilities in certain amounts and for certain periods of time.

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the MBIA policy and MBIA set forth under the heading "BOND INSURANCE".



Additionally, MBIA makes no representation regarding the 2004 Series Bonds or the advisability of investing in the 2004 Series Bonds.

The Financial Guarantee Insurance Policies are not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

**MBIA Information.** The following documents filed by the Company with the Securities and Exchange Commission (the “SEC”) are incorporated herein by reference:

- (1) The Company’s Annual Report on Form 10-K for the year ended December 31, 2003; and
- (2) The Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2004.

Any documents filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act of 1934, as amended, after the date of this Official Statement and prior to the termination of the offering of the 2004 Series Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the SEC filings (including (1) the Company’s Annual Report on Form 10-K for the year ended December 31, 2003, and (2) the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2004) are available (i) over the Internet at the SEC’s web site at <http://www.sec.gov>; (ii) at the SEC’s public reference room in Washington D.C.; (iii) over the Internet at the Company’s web site at <http://www.mbia.com>; and (iv) at no cost, upon request to MBIA Insurance Corporation, 113 King Street, Armonk, New York 10504. The telephone number of MBIA is (914) 273-4545.

As of December 31, 2003, MBIA had admitted assets of \$9.9 billion (audited), total liabilities of \$6.2 billion (audited), and total capital and surplus of \$3.7 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of March 31, 2004 MBIA had admitted assets of \$10.3 billion (unaudited), total liabilities of \$6.5 billion (unaudited), and total capital and surplus of \$3.8 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

***Financial Strength Ratings of MBIA.***

Moody's Investors Service, Inc. rates the financial strength of MBIA “Aaa.”;  
Standard & Poor's, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA “AAA.”;  
Fitch Ratings rates the financial strength of MBIA “AAA.”

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the 2004 Series Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the 2004 Series Bonds. MBIA does not guaranty the market price of the 2004 Series Bonds nor does it guaranty that the ratings on the 2004 Series Bonds will not be revised or withdrawn.

## **SOURCES AND USES OF FUNDS**

The following tables set forth the sources and uses of the proceeds of the 2004 Series Bonds, together with certain other available funds:

### **2004 Series A Bonds**

#### Sources:

Principal amount of 2004 Series A Bonds	<u>\$67,000,000</u>
Total Sources of Funds	<u>\$67,000,000</u>

#### Uses:

Deposit to 2004 Series A Account of Acquisition Fund <sup>(a)</sup>	\$63,890,000
Deposit to Debt Service Reserve Fund:	
2004 Series A Account of Debt Service Reserve Fund	1,340,000
2004 Series B Account of Debt Service Reserve Fund	<u>1,770,000</u>
Total Uses of Funds	<u>\$67,000,000</u>

### **2004 Series B Bonds**

#### Sources:

Principal amount of 2004 Series B Bonds	<u>\$88,500,000</u>
Total Sources of Funds	<u>\$88,500,000</u>

#### Uses:

Deposit to 2004 Series B Account of Acquisition Fund <sup>(a)</sup>	\$20,000,000
Deposit to Redemption Funds <sup>(b)</sup> :	
Series 1992 Bonds	30,000,000
Series 1993 Bonds	20,000,000
Series 1994B Bonds	<u>18,500,000</u>
Total Uses of Funds	<u>\$88,500,000</u>

- (a) *The use of funds in the Acquisition Fund to finance or refinance Student Loans is expected to occur within 45 days of the issuance of the 2004 Series Bonds.*
- (b) *Upon receipt of a like principal amount of Student Loans previously financed with proceeds of such bonds, or, in the case of the Series 1993 Bonds, receipt of approximately \$18,600,000 principal amount of Student Loans previously financed with proceeds of the Series 1993 Bonds and approximately \$1,400,000 (in cash and Student Loans) remaining in the Series 1993 Debt Service Reserve Fund, all of which Student Loans and cash will be deposited in the 2004 Series B Account of the Student Loan Fund and the 2004 Series B Account of the Acquisition Fund, respectively.*

Costs of issuance, including the fees and certain expenses of the Underwriter, the Financial Advisor, the Trustee, the rating agencies, Bond Counsel, the Bond Insurer, and printing and other miscellaneous costs, will be paid from separate funds provided by MHESO.

## **INITIAL ASSET COVERAGE**

Upon the issuance of the 2004 Series Bonds, and after giving effect to the financing and refinancing of Student Loans from the Loan Capital Fund as described under "SOURCES AND USES OF FUNDS," it is anticipated that the aggregate principal amount of Student Loans held in the Student Loan Fund, together with cash and Investment Securities deposited to the Debt Service Reserve Fund, will be equal to approximately 103.5% of the aggregate principal amount of the outstanding 2004 Series Bonds. "Excess Coverage" is the amount by which this ratio exceeds 103%.

Cash flow projections have been prepared for MHESO based upon (i) the characteristics and expected performance of the Student Loans to be deposited to the Student Loan Fund and (ii) the investment of the amounts to be deposited in the Debt Service Reserve Fund. Based upon these assumptions, which MHESO believes are reasonable, such cash flow projections indicate that a gradual increase in the Senior Asset Coverage Ratio should occur. However, the Indenture does not require that any particular asset coverage level be maintained, although it does require that certain procedures be followed and Credit Confirmation obtained prior to the removal of Excess Coverage from the lien of the Indenture. The Indenture requires MHESO to calculate the Senior Asset Coverage Ratio quarterly, beginning with the quarter ended September 30, 2004, and provide such calculation to the Trustee and the Credit Provider. To the extent the Senior Asset Coverage Ratio so calculated is below 101% for any calendar quarter, MHESO is required to purchase or replace any Student Loan in the applicable account of the Student Loan Fund that becomes a Defaulted Student Loan during the succeeding calendar quarter from any available funds of MHESO not held under the Indenture, including, without limitation, amounts in MHESO's Loan Capital Fund (see Appendix II hereto, "DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE – SUMMARIES OF DOCUMENTS – THE SIXTH AND SEVENTH SUPPLEMENTAL INDENTURES – Deposits into Funds and Accounts; Disposition of Proceeds of the Sale of the 2004 Series Bonds; and Use and Disbursements of Funds – Purchase of Defaulted Student Loans").

## **MINNESOTA HIGHER EDUCATION SERVICES OFFICE**

### ***Description of MHESO***

MHESO, as successor to the Minnesota Higher Education Coordinating Board, is an executive branch agency of the State responsible for the coordination and administration of higher education programs among the various public and private institutions of higher education in the State. In addition to its private loan program, known as the Student Educational Loan Fund ("SELF"), MHESO manages financial aid programs for the State, including scholarship, grant, work study and reciprocity programs.

MHESO currently has a staff of 71 people, of which 18 full-time equivalent employees are assigned to the administration of the SELF program. The remaining 53 MHESO employees are involved with MHESO's administration of other financial aid programs, as well as research and facilitation of higher education programs in the State and communication of information to parents and students regarding higher education.

### ***History***

In 1965, the Minnesota State Legislature created the Minnesota Liaison and Facilities Commission for Higher Education. In 1967, the name was changed to Coordinating Commission, and in 1975 it became the Minnesota Higher Education Coordinating Board ("MHECB"). In 1995 the agency was restructured and renamed the Minnesota Higher Education Services Office. In 2003 the Minnesota Legislature gave the agency cabinet level status as an executive branch agency with a director appointed by the Governor and confirmed by the Senate.

In 1973, the Coordinating Commission, and subsequently MHECB, was authorized by the State Legislature to establish and operate a statewide program for making federally insured and guaranteed student loans. From 1973 to 1988, MHECB coordinated the State's participation in the Federal Guaranteed Student Loan Program ("GSL"), serving as the State's lender of last resort. During this time MHECB provided funding for over \$600 million of loans to students under the GSL program. MHECB ceased providing new loans under the GSL program in 1988, as participation by the private sector lenders and secondary markets had gradually replaced the need for the lender of last resort function.

In 1983, MHECB was authorized by the State Legislature to establish and supervise loan programs other than the federally guaranteed programs. In June 1985, MHECB established a loan program known as the Student Educational Loan Fund I ("SELF I"). Approximately \$52.3 million of loans were originated under the SELF I program, of which \$200 were outstanding as of May 31, 2004.

In September 1988, MHECB ceased originating SELF I loans and new loans were made as SELF II loans. Approximately \$654 million of loans have been originated under the SELF II program. No new loans are being originated under the SELF II program. Approximately \$289 million of such loans were outstanding as of May 31, 2004.

In May 2002, MHESO established its SELF III program. Approximately \$218 million of loans have been originated under the SELF III program through May 31, 2004. Approximately \$202 million of such loans were outstanding as of May 31, 2004.

## ***Organization***

The Minnesota Higher Education Services Council (the "Services Council") was created on July 1, 1995. The Services Council consists of eight citizens and one student, each appointed by the governor of the State. Citizen members serve for terms of six years and the student representative serves for two years. As nearly as possible, one-third of the terms are to expire every two years.

The primary Services Council duties are specified in the Act as follows:

- Provide advice and review regarding the performance of MHESO in its duties and in any policies, procedures, or rules MHESO prescribes to perform its duties; and
- Communicate with and make recommendations to the Governor and the State Legislature.

The Services Council is advised by the Minnesota Higher Education Advisory Council (the "Advisory Council"). The Members of the Advisory Council include the President and the Senior Vice-President for Academic Affairs of the University of Minnesota; the Chancellor of the Minnesota State Colleges and Universities; the Associate Vice-Chancellors of the state universities, community colleges and technical colleges; the Minnesota Education Commissioner; the President of the Private College Council; and a representative from the Minnesota Association of Private Post-Secondary Schools. The Advisory Council shall (1) bring to the attention of the Services Council any matters that the Advisory Council deems necessary and (2) review and comment upon matters before the Services Council. The Services Council shall refer all proposals to the Advisory Council before submitting recommendations to the governor and the legislature.

The Services Council is also advised by the Student Advisory Council, the membership of which includes the Chair of the University of Minnesota Student Senate, the State Chair of the Minnesota State University Student Association, the President of the Minnesota Community College Student Association, the President of the Minnesota Technical College Student Association, the President of the Minnesota Association of Private College Students, and a student who is enrolled in a private vocational school, to be appointed by the Minnesota Association of Private Post-Secondary Schools. The Services Council shall inform the Student Advisory Council of all matters related to student issues under consideration and shall refer all proposals to the Student Advisory Council before taking action or sending the proposals to the governor or legislature. The Student Advisory Council shall report to the Services Council quarterly and at other times that the Student Advisory Council considers desirable.

## ***MHESO's Management Team***

The individuals primarily responsible for the overall management and operations of MHESO's financial aid and student loan programs are as follows:

***Susan G. Heegaard, Director, Minnesota Higher Education Services Office.*** Ms. Heegaard was appointed as Director in February 2004 and serves as the Governor's chief advisor on higher education policies and issues. She recently served as a Senior Policy Advisor to Governor Pawlenty for higher education, health, and human services issues. During the administration of Governor Arne Carlson, she served in a number of capacities, including Director of Education Strategy, Assistant Director of Governor Carlson's Office of Federal Relations in Washington, D.C., and Assistant Director of the Office of Minnesota Planning. She has also directed government and community

affairs for the Minnesota Private College Council and worked in Washington, D.C. for U.S. Senator Dave Durenberger.

Ms. Heegaard earned her law degree from William Mitchell College of Law and her bachelor's degree from Skidmore College in Saratoga Springs, New York.

***Cheryl K. Maplethorpe, Director, Division of Student Financial Aid Services.*** Dr. Maplethorpe has been Director of Student Financial Aid Services for MHESO since November 1991, after serving as the manager of Minnesota's financial aid, grant, work study and reciprocity programs since 1980. She is responsible for implementation of aid programs established under the Act and efficient operation of the infrastructure supporting the programs. From 1976 to 1980, Dr. Maplethorpe was Assistant Director for the Financial Aid Office at the University of Iowa. Prior to that she taught science at the American School in Kuwait.

Dr. Maplethorpe holds a Baccalaureate Degree in Science Education and a Master's Degree in Counseling, both from the University of Iowa, and a Ph.D. in Higher Education Policy and Administration from the University of Minnesota. Dr. Maplethorpe served as the 2000-2001 President of the National Association of State Student Grant and Aid Programs (NASSGAP). NASSGAP has been in existence since 1966 and is an association of state grant agencies from across the nation. The association works with the federal government to coordinate student services in areas such as development of financial aid forms that can be utilized at both federal and state levels. NASSGAP also works to influence the federal government to provide increased federal grant aid to students.

***Timothy M. Geraghty, Director, Financial Services.*** Mr. Geraghty has been employed by MHESO and MHECB since February of 1976, and has been MHESO's Director of Financial Services since January of 1998. He was Accounting Director from November 1989 to December 1997. Mr. Geraghty is currently responsible for the accounting functions, agency budget preparation and control, fiscal analysis and data regarding revenue bond issues for MHESO's supplemental loan programs and internal controls of administrative policies for MHESO.

Mr. Geraghty received an Associate of Arts Degree from Anoka-Ramsey Community College and a Bachelor's Degree in Business Administration from the University of Minnesota.

***Marilyn A. Kosir, Manager, Student Loan Programs.*** Ms. Kosir temporarily assumed the responsibilities of Student Loan Manager in March 1995 and assumed those duties on a permanent basis in September of 1995. She is currently responsible for program operation and administrative responsibilities of MHESO's supplemental student loan programs, which involves formulation and implementation of rules, regulations, policies and procedures, bond issue preparation and supervision of staff in the loan origination and loan default collection areas. Ms. Kosir is also responsible for overseeing the activities and performance of MHESO's loan servicer. Prior to assuming her current responsibilities, Ms. Kosir was MHESO's Senior Accounting Officer from July 1990 to September 1995, and prior to that was a Financial Institutions Examiner for the Minnesota Department of Commerce for seven years.

Ms. Kosir holds a Bachelor's Degree in Finance from St. Cloud State University.

***Timothy M. Medd, Audit Manager.*** Mr. Medd has served as Audit Manager for MHESO since August of 1984. From 1982 to 1984 he was an Audit Supervisor Senior. Mr. Medd's current duties and responsibilities include directing the audits of post-secondary educational institutions participating in MHESO's financial aid programs, conducting an annual review of the servicing of MHESO's SELF loans and providing guidance in the operation and administrative responsibilities of the SELF program. Prior to his employment with MHESO, Mr. Medd spent four years as an auditor for the Minnesota Department of Health and five years as a Financial Institutions Examiner for the Minnesota Department of Commerce.

Mr. Medd holds a Master's Degree in Public Administration from Hamline University and a Bachelor's Degree in Business Administration from Minnesota State University-Mankato. He has also taken course work in Accounting from the University of Minnesota.

***Danette M. Jerry, Financial Services Manager.*** Ms. Jerry is responsible for the management of records for MHESO's Loan Capital Fund. Ms. Jerry's responsibilities include preparation of financial statements and bond compliance reports, management of MHESO's investment portfolio and monitoring cash needs for the Loan Capital Fund. Ms. Jerry also supervises MHESO's Accounts Payable and Payroll staff and the Graduated Repayment

Income Protection Program. Prior to joining MHESO in October 1995, Ms. Jerry worked as an Account Technician for the Minnesota Department of Corrections.

Ms. Jerry attended Northwestern College in Roseville, Minnesota and completed the Accounting Program at Brainerd Technical College.

## ***Financial Information***

***Prior Financing Activities.*** MHECB has issued \$1,048 billion in aggregate principal amount of revenue bonds under its various loan programs since 1973, primarily relating to its previous lending activities under the GSL program. MHECB discontinued originating federal loans in 1988, and as of May 31, 2004, MHESO held approximately \$490,000 of GSL loans in its Loan Capital Fund.

Approximately \$403 million of the revenue bonds previously issued by MHECB and MHESO related to its supplemental student loan programs. Of this amount, ten series of bonds aggregating \$300 million in principal amount remained outstanding as of June 30, 2004. These issues are:

- \$10,000,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992A,
- \$10,000,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992B,
- \$10,000,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992C,
- \$20,000,000 Supplemental Student Loan Program Variable Rate Refunding Bonds, Series 1993,
- \$18,500,000 Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1994B,
- \$61,200,000 Supplemental Student Loan Program Revenue Bonds 1999 Series A (Taxable),
- \$68,200,000 Supplemental Student Loan Program Revenue Bonds 2002 Series A (Taxable),
- \$27,100,000 Supplemental Student Loan Program Revenue Bonds 2002 Series B (Tax Exempt),
- \$64,700,000 Supplemental Student Loan Program Revenue Bonds 2003 Series A (Taxable), and
- \$10,300,000 Supplemental Student Loan Program Revenue Bonds 2003 Series B (Tax Exempt).

The 1999 Series Bonds, the 2002 Series Bonds and the 2003 Series Bonds were issued under the Indenture. The Series 1992 Bonds, the Series 1993 Bonds and the Series 1994B Bonds were issued under separate indentures and will be refunded by the 2004 Series B Bonds. The Trustee will transfer to the respective redemption funds of the Series 1992 Bonds, the Series 1993 Bonds and the Series 1994B Bonds proceeds of the 2004 Series B Bonds sufficient to pay the redemption price thereof upon receipt of a like principal amount of Student Loans previously financed with proceeds of the Series 1992 Bonds and the Series 1994B Bonds, or, in the case of the Series 1993 Bonds, receipt of approximately \$18,600,000 principal amount of Student Loans previously financed with proceeds of the Series 1993 Bonds and approximately \$1,400,000 (in cash and Student Loans) remaining in the Series 1993 Debt Service Reserve Fund, such moneys will be deposited in the 2004 Series B Account of the Student Loan Fund and the 2004 Series B Account of the Acquisition Fund, respectively. Upon such redemption, any remaining assets will be released to MHESO and deposited into the Loan Capital Fund and will not be pledged to the Bonds issued under the Indenture.

MHESO is authorized to have outstanding an aggregate \$850 million of revenue bonds, exclusive of refunded and defeased bonds. Neither bonds issued by MHESO, nor bonds previously issued by MHECB, constitute debt of the State.

**Operating Budget.** MHESO's 2003-2004 operating budget, exclusive of its supplemental student loan programs, is \$188,715,000, of which it is anticipated \$5,762,000 will come from federal appropriations, \$178,053,000 from State appropriations, and \$4,900,000 from miscellaneous special appropriations. None of these funds are available for use in the Supplemental Student Loan Program or any other student loan programs. None of these funds are available for the payment of the outstanding bonds referenced above.

**General Financial Information.** The Loan Capital Fund ("LCF"), which is maintained as an Enterprise Fund of MHESO, is the funding source for MHESO's student loan activities, both present and future. Certain summary financial information for the LCF for the past three years is presented in the table below. MHESO anticipates using loans that qualify as Student Loans pursuant to the terms of the Indenture and money in the LCF to replace or repurchase Defaulted Student Loans, to pay certain Program Expenses and costs of issuance. However, the LCF is not pledged to pay the 2004 Series Bonds.

#### SUMMARY FINANCIAL DATA FOR THE LOAN CAPITAL FUND

	Fiscal Year Ended June 30,		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Total assets	\$572,626,091	\$522,672,996	\$416,174,439
Total cash and investments	135,184,881	141,224,842	90,493,859
Total loans outstanding	433,331,555	376,429,811	320,951,015
Allowance for loan losses	4,417,656	4,030,617	3,353,224
Total revenues	18,688,622	23,760,282	29,730,187
Total expenses	<u>43,442,266*</u>	<u>11,950,573</u>	<u>14,213,615</u>
Excess of revenues over expenses	(24,753,644)	11,809,709	15,516,572
Unrestricted fund balance		\$298,270,615	\$286,460,906
Restricted net assets	\$273,516,971		

\*Includes \$30,000,000 transfer to the State of Minnesota General Fund.

For more detailed information concerning the LCF, please refer to Appendix I attached hereto.

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## **THE SUPPLEMENTAL STUDENT LOAN PROGRAM**

### ***SELF Program Overview***

*Background.* MHECB, and subsequently MHESO, was authorized by the State Legislature in 1985 to establish and supervise loan programs other than the Guaranteed Student Loan program ("GSL"). MHECB began originating supplemental loans in June of 1985 under its Student Educational Loan Fund I program ("SELF I") and completed originations under SELF I in September of 1988. At that time MHECB began originating loans under its Student Educational Loan Fund II program ("SELF II"). In May 2002 MHESO established its SELF III program. Currently, all student loans originated by MHESO are made pursuant to its SELF III Program.

Together, MHECB and MHESO have originated approximately \$922 million of loans under the SELF I, SELF II and SELF III Programs through May 31, 2004. The following table shows the outstanding principal balance of SELF loans at the dates indicated:

	(\$ in Thousands)			
	<u>SELF I</u>	<u>SELF II</u>	<u>SELF III</u>	<u>Total</u>
<u>As of May 31, 2004</u>	\$ 0	\$ 288,662	\$ 202,384	\$ 491,046
<u>As of June 30,</u>				
2003	\$ 2	\$ 330,223	\$ 99,346	\$ 429,571
2002	9	369,839	1,524	371,372
2001	32	314,508		314,540
2000	198	260,922		261,120
1999	849	209,876		210,725
1998	2,962	172,788		175,750
1997	4,093	168,812		172,905
1996	7,113	168,740		175,853
1995	11,021	169,468		180,489
1994	14,909	162,976		177,885
1993	20,428	154,088		174,516
1992	24,240	122,809		147,049
1991	34,286	85,686		119,972
1990	40,724	49,948		90,672
1989	46,672	17,993		64,665
1988	39,816	--		39,816
1987	21,279	--		21,279

MHESO (and previously MHECB) finances the origination of SELF III loans with the proceeds of revenue bond issues and amounts available in the Loan Capital Fund. Although MHESO receives State and Federal appropriations, the SELF program is required by statute to be self-sustaining, and such appropriations are neither available for use in the SELF Program nor available for the payment of principal of and interest on any of the associated revenue bonds (including the 2004 Series Bonds).

### ***Program Terms and Conditions***

MHESO has promulgated rules and regulations for the administration of the SELF program, including provisions specifying eligible institutions, eligible students, loan size, costs to the borrower, loan disbursement, loan repayment, security for loan repayment and collections. Many of the terms and conditions relating to SELF loans are set forth in the Act.

The following paragraphs describe the current terms, conditions and applicable rules and regulations pertinent to the SELF program. In the past, MHESO has modified and supplemented these terms, conditions, rules and regulations,



and reserves the right to further modify and supplement them in the future, subject to its receipt of a Credit Confirmation with regard to all Student Loans pledged to secure payment of the 2004 Series Bonds.

**Loan Size.** The size of individual loans is determined by the appropriate campus financial aid administrator after giving consideration to: (i) the cost of attendance as defined by the institution, (ii) other Federal financial aid, including both loans and grants, that have been accepted by the student, (iii) other state and institutional financial aid that has been accepted by the student, and (iv) other financial aid known to have been received by the student from private sources (i.e. private foundations, unions, corporations, etc.). The amount of the SELF loan, in combination with student aid from all known sources, will not be allowed to exceed the cost of attendance as defined by the enrolling institution.

**Loan Limits.** The minimum SELF loan amount is \$500. The maximum SELF loan amounts, which are prescribed by statute, are designed to protect students from accumulating unreasonable levels of debt burden, while also providing the students with an incentive to defer borrowing until absolutely necessary. Such maximum loan amounts are set according to Grade Level (as defined below) as follows:

- \$4,500 per year for undergraduates during Grade Levels 1 and 2;
- \$6,000 per year for undergraduates during Grade Levels 3, 4 and 5, subject to a cumulative maximum of \$25,000; and
- \$9,000 per year for graduate students, subject to a cumulative maximum of \$40,000 (including undergraduate borrowings).

**Grade Level.** Grade Level indicates the relative status of an eligible student in a degree or certificate granting program and usually corresponds to an academic year. For example, an eligible student in the second year of a four-year program would be in Grade Level 2.

**Interest Rates.** The interest rate on SELF II loans is adjusted quarterly, based upon the average of the weekly auction investment rates on 13-week Treasury Bills, plus a margin determined by MHESO with a Credit Confirmation as applicable (the current margin is 2.00%). The interest rate applicable for the quarter ending September 30, 2004 is 3.00%. The interest rate on SELF II loans may be adjusted, either upward or downward, but not more than 2.00% during any 12-month period.

The interest rate on SELF III loans is adjusted quarterly, based upon the average of the three month London Interbank Offered Rates (LIBOR), plus a margin determined by MHESO (the current margin is 3.30%). The interest rate applicable for the quarter ending September 30, 2004 is 4.60%. The interest rate on SELF III loans may be adjusted, either upward or downward, but not more than 3.00% during any 12-month period.

**Loan Disbursement.** SELF loans are disbursed in accordance with applicable periods of enrollment. For example, an applicant eligible to receive a \$1,500 SELF III loan and attending a 2-semester school would receive a check for \$750 at the beginning of each semester. Likewise, a student attending school on a quarterly schedule would receive \$500 at the beginning of each term for an academic year consisting of three quarters. Loan checks are made jointly payable to the borrower and the institution, and each such party must sign the check to negotiate it. Schools may elect to have loan disbursements sent electronically.

**Loan Repayment.** The repayment provisions for SELF loans have been developed to provide maximum repayment flexibility for the borrower while in school and to maintain the financial integrity of the Program.

Under the standard repayment plan, quarterly interest payments begin within 3 months of disbursement. Monthly interest payments are then required for 12 months after the borrower leaves school. Monthly principal and interest payments begin on the 13<sup>th</sup> month after graduation or termination of study, subject to a maximum repayment term equal to the lesser of: (i) 10 years from graduation/termination, *or* (ii) 15 years from the first disbursement of their first SELF loan.

An additional 24-month period of interest only payments after the standard 12-month grace period is available upon request, subject to the same maximum repayment terms described above. There are no penalties assessed for prepayment of loans.

Whenever a borrower is delinquent in interest or principal payments for more than 30 days, the co-signer will be expected to meet the obligation until such time as the borrower may resume payments. MHESO will accept payments from third parties (e.g., educational institutions, foundations, community organizations or employers) to assist or fulfill student payment obligations. However, the ultimate obligation for repayment of SELF loans remains that of the borrower and co-signer.

***Eligible Institutions.*** An Eligible Institution is defined as a post-secondary institution that either: (i) is operated or regulated by the State, *or* (ii) if operated publicly or privately in another state, is approved by the U.S. Department of Education, *or* (iii) is chartered in the Canadian Province of Manitoba. All such institutions are required to have their Chief Executive Officer sign a SELF Participation Agreement (as described below) agreeing to perform certain administrative procedures in loan processing and student counseling.

With respect to institutions described in items (ii) and (iii) above, such schools must maintain academic standards substantially equal to those of comparable institutions operated in the State, as determined by MHESO.

The SELF Participation Agreement requires that institutions make proper certifications and deliver loan funds to student borrowers. Such certifications involve verifying and documenting the identity, eligible enrollment, satisfactory academic progress and cost of attendance of the borrower, calculating maximum allowable loan eligibility and recommending a specific loan amount. Institutions are also required to verify students' prior borrowing histories.

***Eligible Borrowers.*** Borrowers must either be enrolled at an Eligible Institution (as defined above) in the State or be a Minnesota resident enrolled at an Eligible Institution in another state. Borrowers must also:

- be enrolled at least half-time in a program leading to a certificate, associate, baccalaureate, masters, doctorate or other professional degree;
- be making satisfactory progress in an approved course of study;
- not currently be in default under any State, federal or other private student loan program;
- not be delinquent in the payment of principal of or interest on any SELF loan;
- have agreed to the release of information to a consumer credit reporting agency; and
- have a creditworthy co-signer, as defined below.

***Co-Signer Credit Criteria.*** MHESO underwrites each loan and assesses the creditworthiness of the co-signer. The co-signer must be a U.S. citizen or permanent resident, be at least 18 years old and have demonstrated to the satisfaction of MHESO that he or she has not had difficulty in repaying debts.

MHESO verifies the creditworthiness of co-signers by checking information available through one of several national credit bureaus. If information is not found on a credit bureau file, the co-signer must complete a personal financial statement, which is used to determine creditworthiness. If a co-signer has no credit history, the co-signer must demonstrate a net worth equal to or exceeding ten times the size of each SELF III loan requested.

In order to be considered creditworthy, prospective co-signers must meet the following criteria: (i) no credit bureau balances discharged through bankruptcy, (ii) no garnishments, attachments, foreclosures, repossessions or suits, (iii) no delinquent or unsatisfied credit obligations such as tax liens, mechanics liens or other judgments, (iv) no more than 5% of current credit bureau balances past due. A co-signer may be considered creditworthy if the total amount of unsatisfied liens, judgments or past due balances does not exceed \$50.

### ***Loss and Delinquency Experience for the Student Loan Portfolio***

The tables that follow set forth, with regard to SELF II and SELF III loans, loan loss and recovery experience, shown on an annual basis for the fiscal years ended June 30, 1997 through 2003, and borrower delinquencies, shown on a monthly basis for the months ended December 2003 through May 2004. There can be no assurance, however, that the loss and recovery experience or borrower delinquencies for the SELF II and SELF III loans will be similar to the historical experience set forth on the next two pages.

## SELF II Program

### Loss Experience for the Student Loan Portfolio

	12 Months Ended June 30, 2003	12 Months Ended June 30, 2002	12 Months Ended June 30, 2001	12 Months Ended June 30, 2000	12 Months Ended June 30, 1999	12 Months Ended June 30, 1998	12 Months Ended June 30, 1997
Average Receivables Outstanding**	\$349,583,495	\$350,985,915	\$294,260,367	\$224,923,188	\$195,285,062	\$171,310,997	\$169,829,691
Gross Losses	\$5,361,271	\$3,864,826	\$3,068,080	\$1,321,283	\$1,327,928	\$1,832,479	\$2,132,413
Recoveries	<u>3,206,561</u>	<u>2,585,736</u>	<u>1,983,254</u>	<u>1,511,185</u>	<u>2,038,004</u>	<u>1,875,618</u>	<u>1,852,051</u>
Net Losses*	\$2,154,710	\$1,279,090	\$1,084,826	(\$ 189,902)*	(\$ 710,076)*	(\$ 43,139)*	\$ 280,362
Net Losses as Percentage of Average Receivables Outstanding	0.62%	0.36%	0.37%	(0.08%)	(0.36%)	(0.04%)	0.17%

\*Recoveries were greater than gross losses for the year.

\*\*Average Receivables Outstanding is the arithmetic average of receivables outstanding during the period indicated.

### Delinquencies for the Student Loan Portfolio

(Dollars in Thousands)

	May 31, 2004		April 30, 2004		March 31, 2004		February 29, 2004		January 31, 2004		December 31, 2003	
Days Delinquent	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
15-44	\$14,447	5.0%	\$12,044	4.1%	\$15,120	5.1%	\$14,531	4.8%	\$14,468	4.8%	\$18,816	6.1%
45-59	1,086	0.4	1,176	0.4	1,197	0.4	1,193	0.4	1,674	0.5	1,862	0.6
60-89	2,796	1.0	3,127	1.1	2,884	1.0	3,183	1.1	3,844	1.3	4,044	1.3
90-119	1,507	0.5	1,205	0.4	1,204	0.4	1,484	0.5	1,678	0.5	1,679	0.6
120 and Over	<u>783</u>	<u>0.2</u>	<u>661</u>	<u>0.2</u>	<u>1,016</u>	<u>0.3</u>	<u>1,221</u>	<u>0.4</u>	<u>1,476</u>	<u>0.5</u>	<u>1,322</u>	<u>0.4</u>
Total	\$20,619	7.1%	\$18,213	6.2%	\$21,421	7.2%	\$21,612	7.2%	\$23,140	7.6%	\$27,723	9.0%

## SELF III Program

### Loss Experience for the Student Loan Portfolio

	12 Months Ended <u>June 30, 2003</u>
Average Receivables Outstanding*	\$59,186,680
Gross Losses	\$27,453
Recoveries	<u>68</u>
Net Losses	\$27,385
Net Losses as Percentage of Average Receivables Outstanding	0.05%

\*Average Receivables Outstanding is the arithmetic average of receivables outstanding during the period indicated.

### Delinquencies for the Student Loan Portfolio

(Dollars in Thousands)

	May 31, 2004		April 30, 2004		March 31, 2004		February 29, 2004		January 31, 2004		December 31, 2003	
Days Delinquent	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
15-44	\$8,269	4.1%	\$6,402	3.2%	\$9,337	4.7%	\$6,468	3.3%	\$5,975	3.2%	\$8,660	5.8%
45-59	69	0.0	114	0.1	75	0.0	56	0.0	111	0.0	89	0.0
60-89	1,768	0.9	2,051	1.0	1,503	0.8	1,485	0.8	1,596	0.9	1,412	1.0
90-119	994	0.5	577	0.3	503	0.3	528	0.3	397	0.2	448	0.3
120 and Over	<u>379</u>	<u>0.2</u>	<u>198</u>	<u>0.1</u>	<u>260</u>	<u>0.1</u>	<u>282</u>	<u>0.2</u>	<u>297</u>	<u>0.2</u>	<u>287</u>	<u>0.2</u>
Total	\$11,479	5.7%	\$9,342	4.7%	\$11,678	5.9%	\$8,819	4.6%	\$8,376	4.5%	\$10,896	7.3%

## **LOAN SERVICING AND COLLECTIONS**

MHESO has contracted with Nelnet, Inc. for the servicing of SELF loans. The Servicer has subcontracted with Firstmark Services, LLC, an affiliate of the Servicer that specializes in servicing alternative loans, to service MHESO loans. While MHESO's staff is primarily responsible for loan origination processing and defaulted loan collections, the Servicer is responsible for disbursing SELF loans and for effecting billing procedures, which commence with the first interest payment, and payment processing.

Nelnet, Inc., formerly known as Nelnet Loan Services, Inc., a Nebraska corporation, began its education loan servicing operations on January 1, 1978, and provides education loan servicing, time-sharing, administration and other services to lenders, secondary market purchasers and guaranty agencies throughout the United States. Nelnet offers student loan servicing to lending institutions and secondary markets. Nelnet has offices located in Aurora, Colorado; Lincoln, Nebraska; Jacksonville, Florida; and Indianapolis, Indiana and, as of May 31, 2004, employed a total of 943 employees. As of May 31, 2004, Nelnet serviced more than \$19.7 billion in student loans. For more information on the Servicer and its services, visit [www.nelnet.net](http://www.nelnet.net).

***Delinquency Procedures.*** If a borrower becomes delinquent in the payment of their SELF loan, the Servicer institutes collection procedures with both the borrower and co-signer, including computer-generated late notices and letters, telephone contact and other collection procedures.

A payment notice is mailed to each borrower at least 20 days prior to the payment due date. If the payment is not received on the due date, the loan is considered late. The following summarizes the steps the Servicer takes to cure a delinquent loan:

<u># of Days Delinquent</u>	<u>Action Performed by Servicer</u>
15 Days Late	Notice is sent to borrower
30 Days Late	Notice is sent to the borrower and co-signer; telephone call to borrower
45 Days Late	Telephone call to borrower and co-signer
60 Days Late	Letter to both borrower and co-signer
75 Days Late	Telephone call to borrower and co-signer
90 Days Late	Notice of demand for payment to borrower and co-signer; telephone call to borrower and co-signer
105 Days Late	Demand letters sent to both borrower and co-signer (printed on MHESO letterhead)
110 Days Late	Telephone call to borrower and co-signer
120 Days Late	Servicer returns loan to MHESO for claim on borrower and co-signer

***Default Collection Procedures.*** Once a SELF loan has defaulted, MHESO will take one or more of the following actions:

- Work to effect repayment through the Minnesota Revenue Recapture Act <sup>1</sup>
- Take legal action against the borrower for repayment
- Take legal action against the co-signer for repayment
- Report the borrower's defaulted loan to the credit bureau
- Report the co-signer's default to the credit bureau
- Turn the account over to a collection agency

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<sup>1</sup> Under this law, the borrower and/or the co-signer's state income tax, state lottery winnings and property tax refunds and other refunds may in certain circumstances be diverted to MHESO to repay amounts owed relating to a defaulted SELF loan.

## **TAX MATTERS**

### ***2004 Series A Bonds (Taxable)***

#### **United States Federal Income Tax Consequences**

The following discussion is a summary of certain United States federal income tax consequences resulting from the beneficial ownership of 2004 Series A Bonds by certain persons. This summary does not consider all the possible United States federal tax consequences of the purchase, ownership or disposition of the 2004 Series A Bonds and is not intended to reflect the individual tax position of any beneficial owner. Moreover, except as expressly indicated, it addresses initial purchasers of a 2004 Series A Bond at its issue price, which is the first price to the public at which a substantial amount of the 2004 Series A Bonds is sold, and does not address beneficial owners that may be subject to special tax rules, such as banks, insurance companies, dealers in securities or currencies, purchasers that hold 2004 Series A Bonds or foreign currency as a hedge against currency risks or as part of a straddle with other investments or as part of a synthetic security or other integrated investment (including a conversion transaction) comprised of a 2004 Series A Bond and one or more other investments, or purchasers that have a functional currency other than the United States dollar. This summary is not applicable to non-United States persons not subject to United States federal income tax on their worldwide income. This summary is based upon current provisions of the Internal Revenue Code of 1986, as amended (the "Code"), judicial decisions and administrative interpretations and does not take into account possible changes in the tax laws or these interpretations, any of which may be applied retroactively. There can be no assurance that the Internal Revenue Service will take a similar view of such considerations. It does not discuss the tax laws of any state, local or foreign governments. It does not discuss the tax treatment of 2004 Series A Bonds denominated in certain hyper inflationary currencies or dual currency 2004 Series A Bonds.

Persons considering the purchase of 2004 Series A Bonds are strongly urged and expected to consult their own tax advisors concerning the United States federal income tax consequences to them in light of their particular situations as well as any consequences to them under the laws of any other taxing jurisdiction.

#### **United States Federal Income Tax Consequences to United States Holders**

***Payments of Interest.*** In general, interest on a 2004 Series A Bonds will be taxable to a beneficial owner which is a United States holder of the 2004 Series A Bond.

In the opinion of Bond Counsel, based on an analysis of existing laws, regulations, rulings and court decisions and assuming, among other matters, compliance with certain covenants, interest on the 2004 Series B Bonds is excluded from gross income for federal income tax purposes. Interest on the 2004 Series B Bonds is a specific preference item for purposes of the federal individual and corporate alternative minimum taxes.

For purposes of the following summary, the term United States holder refers generally to: (1) a citizen or resident of the United States, (2) a corporation created or organized under the laws of the United States or any state thereof (including the District of Columbia) or (3) a person otherwise subject to United States federal income taxation on its worldwide income. Interest will be taxable as ordinary income at the time it is received or accrued, depending on the holder's method of accounting for tax purposes. If a partnership holds 2004 Series A Bonds, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. Partners of partnerships holding 2004 Series A Bonds should consult their tax advisors.

***Purchase, Sale, Exchange and Retirement of the 2004 Series A Bonds.*** A United States holder's tax basis in a 2004 Series A Bond generally will equal its cost, increased by any market discount and original issue discount included in the United States holder's income with respect to the 2004 Series A Bond, and reduced by the amount of any amortizable bond premium applied to reduce interest on the 2004 Series A Bond. A United States holder generally will recognize gain or loss on the sale, exchange or retirement of a 2004 Series A Bond equal to the difference between the amount realized on the sale or retirement and the United States holder's tax basis in the 2004 Series A Bond. Except to the extent a 2004 Series A Bond is purchased at a market discount, and except to the extent attributable to accrued but unpaid interest, gain or loss recognized on the sale, exchange or retirement of a

2004 Series A Bond will be capital gain or loss and will be long-term capital gain or loss if the 2004 Series A Bond was held for more than one year.

### **Information Reporting and Back-up Withholding**

For each calendar year in which the 2004 Series A Bonds are outstanding, MHESO is required to provide the Internal Revenue Service with certain information, including the holder's name, address and taxpayer identification number (either the holder's Social Security number or its employer identification number, as the case may be), the aggregate amount of principal and interest paid to that holder during the calendar year and the amount of tax withheld, if any. This obligation, however, does not apply with respect to certain United States holders, including corporations, tax-exempt organizations, qualified pension and profit sharing trusts and individual retirement accounts.

If a United States holder subject to the reporting requirements described above fails to supply its correct taxpayer identification number in the manner required by applicable law or under reports its tax liability, MHESO, its agents or paying agents or a broker may be required to backup withhold a tax equal to 28% of each payment of principal of, interest on, and any premium on the 2004 Series A Bonds. This backup withholding is not an additional tax and may be credited against the United States holder's federal income tax liability, provided that the Bondholder furnishes the required information to the Internal Revenue Service.

Payments of the proceeds from the sale of a 2004 Series A Bond to or through a foreign office of a broker will not be subject to information reporting or backup withholding. However, information reporting (but not backup withholding) may apply to those payments if the broker is one of the following: (a) a United States person, (b) a foreign custodian, nominee, other agent or broker that derives 50% or more of its gross income for certain periods from the conduct of a trade or business in the United States, (c) a foreign custodian, nominee, other agent or broker that is a controlled foreign corporation for United States tax purposes, or (d) a foreign partnership if at anytime during its tax year one or more of its partners are United States persons who, in the aggregate, hold more than 50% of the income or capital interest of the partnership or if, at any time during its taxable year, the partnership is engaged in the conduct of a trade or business within the United States, unless the custodian, nominee, other agent, broker or foreign partnership has documentary evidence in its records that the beneficial owner is not a United States person and certain other conditions are met.

The federal income tax discussion set forth above is included for general information only and may not be applicable depending upon a holder's particular situation. Holders should consult their tax advisors with respect to the tax consequences to them of the purchase, ownership and disposition of the 2004 Series A Bonds, including the tax consequences under state, local, foreign and other tax laws and the possible effects of changes in federal or other tax laws.

### **State Tax Considerations**

In addition to the federal income tax consequences described in "United States Federal Income Tax Consequences," potential investors should consider the state income tax consequences of the acquisition, ownership and disposition of the 2004 Series A Bonds. State income tax law consequences may differ substantially from the corresponding federal law, and this discussion does not purport to describe any aspect of the income tax laws of any state. Therefore, potential investors should consult their own tax advisors with respect to the various state tax consequences of an investment in the 2004 Series A Bonds.

### ***2004 Series B Bonds (Tax Exempt)***

As of the date of issuance, in the opinion of Best & Flanagan LLP, Bond Counsel, interest on the 2004 Series B Bonds is, under existing law, excluded from gross income for Federal income tax purposes. Interest on the 2004 Series B Bonds is an item of tax preference for purposes of the Federal alternative minimum tax imposed on individuals and corporations. However, the exemption from gross income under the Code may become inapplicable either with respect to 2004 Series B Bonds, as of either the date of issuance of the 2004 Series B Bonds or on a later

date, upon the occurrence of certain subsequent events, including, without limitation, (1) the proceeds of the 2004 Series B Bonds being expended in a manner or for a use inconsistent with certain applicable requirements of Sections 141 or 144 of the Code or (2) the investment of amounts in "nonpurpose obligations" (as defined in Section 148 of the Code) or the application of the earnings of investments in said "nonpurpose obligations", in each case in a manner contrary to the requirements of Section 148 of the Code. In addition to the foregoing exceptions, the opinion set forth in the first sentence of this paragraph is subject to the condition that the Issuer and the Trustee comply with all requirements of the Code that must be satisfied subsequent to the issuance of the 2004 Series B Bonds in order that interest thereon be, or continue to be, excluded from gross income for Federal income tax purposes. The Issuer and the Trustee have covenanted to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of interest on the 2004 Series B Bonds in gross income for Federal income tax purposes to be retroactive to the date of issuance of the 2004 Series B Bonds. No opinion is expressed regarding other Federal tax consequences arising with respect to the 2004 Series B Bonds. The 2004 Series B Bonds are not "arbitrage bonds" within the meaning of Section 148 of the Code.

In addition to the foregoing, the Code contains the following provision which affects certain taxpayers:

Interest on the 2004 Series B Bonds is an item of tax preference includible in the computation of the alternative minimum tax imposed with respect to individuals and corporations, and interest on the 2004 Series B Bonds will be included in the computation of "adjusted current earnings" for the purpose of calculating the alternative minimum tax that may be imposed with respect to corporations.

The Code further provides that interest on the 2004 Series B Bonds is includible in the calculation of modified adjusted gross income in determining whether Social Security or railroad retirement payments are to be included in taxable income of individuals.

2004 SERIES B BONDHOLDERS SHOULD CONSULT THEIR TAX ADVISOR WITH RESPECT TO THE CALCULATIONS OF ALTERNATIVE MINIMUM TAX OR FOREIGN BRANCH PROFITS TAX LIABILITY, OR THE INCLUSION OF SOCIAL SECURITY OR OTHER RETIREMENT PAYMENTS IN TAXABLE INCOME.

It is the further opinion of Bond Counsel that, under existing law, interest on the 2004 Series B Bonds is not includible in gross income for the purpose of Minnesota income taxes, except for Minnesota corporate and bank excise taxes measured by income. See "APPENDIX VI" for the full text of a form of the opinion proposed to be rendered by Bond Counsel.

## **UNDERWRITING**

The 2004 Series Bonds will be purchased on the date of issuance by RBC Dain Rauscher Inc. (the "Underwriter"). The Underwriter will be paid a fee of \$545,000 for underwriting the 2004 Series Bonds. MHESO has agreed to indemnify the Underwriter against certain liabilities, including liabilities under the Federal securities laws.

## **FINANCIAL ADVISOR**

Public Financial Management, Inc. (the "Financial Advisor"), Minneapolis, Minnesota, has been retained by MHESO to serve as financial advisor with respect to the 2004 Series Bonds. The Financial Advisor has assisted MHESO in matters relating to the planning, structuring, and issuance of the 2004 Series Bonds and various other debt related matters. In preparing the Official Statement, the Financial Advisor has relied upon MHESO officials, and other sources, who have access to relevant data to provide accurate information for the Official Statement, and the Financial Advisor has not been engaged, nor has it undertaken, to independently verify the accuracy of such information. The Financial Advisor is not a public accounting firm and has not been engaged by MHESO to compile, review, examine or audit any information in the Official Statement in accordance with accounting



standards. The Financial Advisor is an independent advisory firm and is not engaged in the business of underwriting, trading or distributing municipal securities or other public securities and therefore will not participate in the underwriting of the 2004 Series Bonds.

## **LITIGATION**

There is no controversy or litigation of any nature now pending or threatened restraining or contesting the validity of the 2004 Series Bonds or any proceedings of MHESO taken with respect to the issuance or sale thereof, or the pledge or application of any moneys or security provided for the payment of the 2004 Series Bonds or the existence or powers of MHESO.

## **RATINGS**

Upon delivery of the MBIA Policy, Moody's Investors Service, Inc. and Fitch Ratings will assign their municipal bond ratings of "Aaa" and "AAA" respectively to the 2004 Series Bonds, based upon the delivery of the 2004 Series Bonds Financial Guaranty Insurance Policy insuring payment when due of the principal of and interest (but not any Carry-over Amounts on the 2004 Series A Bonds) on the 2004 Series Bonds. Such ratings reflect only the views of the rating agencies and an explanation of the significance of such ratings can only be obtained from the rating agency furnishing the same. No assurance can be given that such ratings will be continued for any given period of time or that they will not be revised downward or withdrawn entirely by the rating agencies furnishing the same, if, in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect upon the market price or the marketability of the 2004 Series Bonds.

Fitch Ratings has stated that its ratings on the 2004 Series Bonds do not address: (a) the market liquidity of the 2004 Series Bonds, or (b) any Carry-over Amount that may accrue with respect to the 2004 Series A Bonds.

## **LEGAL MATTERS**

### ***Compliance with SEC Rule 15c2-12***

MHESO has provided the Underwriter with a copy of its Official Statement, dated July 20, 2004. As of its date, the Official Statement was "deemed final" by MHESO for the purpose of SEC Rule 15c2-12(b)(1), absent only the types of information in SEC Rule 15c2-12(b)(1).

MHESO has agreed with the Underwriter in the Bond Purchase Agreement, in compliance with SEC Rule 15c2-12(b)(3), to deliver to the Underwriter, within seven days of the date of the Bond Purchase Agreement, copies of the final Official Statement in sufficient quantity to comply with SEC Rule 15c2-12(b)(4) and the rules of the Municipal Securities Rulemaking Board.

### ***Availability of Information***

MHESO and the Trustee will enter into a Continuing Disclosure Agreement (the "Disclosure Agreement") in substantially the form attached hereto as Appendix IX to provide for the public availability of information relating to the 2004 Series Bonds and to comply with rules and regulations applicable to the disclosure of information in the municipal bond market. The Disclosure Agreement may be amended from time to time without the consent of Bondholders to the extent the parties thereto deem it necessary or desirable to comply with applicable law,

regulations and rules relating to continuing disclosure regarding tax-exempt securities, including rules promulgated by the Securities and Exchange Commission under Rule 15c2-12 or otherwise.

The Trustee is appointed the Dissemination Agent for the purpose of disclosing the information described in the Disclosure Agreement. The Trustee will make available to a nationally recognized municipal securities information repository (the "Repository") all of the information described in the next paragraph of which the Trustee has actual knowledge or which has been reported to the Trustee. The Trustee will supply to any Bondholder who requests such information, any information transmitted to the Repository.

By 150 days after the end of MHESO's fiscal year beginning June 30, 2004, MHESO shall provide the Dissemination Agent with its Annual Financial Information, which shall include:

- A complete audit report and opinion of an Accountant and MHESO's financial statements for such fiscal year.
- To the extent not included in the financial statements described immediately above, the following information which may be unaudited but shall be certified as to accuracy and completeness by MHESO's Director of Financial Services:
  - Information regarding MHESO's operating budget and the Loan Capital Fund
  - Information regarding the amount of Student Loans originated, the outstanding principal balance of Student Loans and loan loss and recovery experience and borrower delinquencies.

MHESO shall cause the Dissemination Agent to provide the Annual Financial Information not later than 155 days after the end of MHESO's fiscal year to each then existing (i) nationally recognized municipal securities information repository (NRMSIR) and (ii) state information depository (SID) for the State.

If a Material Event occurs while any 2004 Series Bonds are outstanding, MHESO shall provide, or shall provide to the Dissemination Agent for dissemination in a timely manner to each then existing NRMSIR and SID, notice of any such Material Event. Material Events include:

- Principal and interest payment delinquencies;
- Non-payment of related defaults;
- Unscheduled draws on debt service reserves reflecting financial difficulties;
- Unscheduled draws on credit enhancements reflecting financial difficulties;
- Substitution of credit or liquidity providers, or their failure to perform;
- Adverse tax opinions or events affecting the tax-exempt status of the security;
- Modifications to rights of 2004 Series Bond owners;
- 2004 Series Bond calls;
- Defeasances;
- Release, substitution, or sale of property securing repayment of the 2004 Series Bonds; and
- Rating changes.

Failure of MHESO or the Trustee to comply with any provisions of the Disclosure Agreement shall constitute a default thereunder and any party aggrieved thereby, including the owners of any 2004 Series Bonds, may take whatever action at law or in equity may appear necessary or appropriate to enforce performance and observance of any agreement or covenant contained in the Disclosure Agreement.

In no event shall a default under the Disclosure Agreement constitute an event of default under the Indenture.

## ***ERISA Considerations***

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), imposes certain fiduciary and prohibited transaction restrictions on employee pension and welfare benefit plans subject to ERISA ("ERISA Plans"). Section 4975 of the Code imposes essentially the same prohibited transaction restrictions on tax-qualified retirement plans described in Section 401(a) of the Code ("Qualified Retirement Plans") and on Individual Retirement Accounts ("IRAs") described in Section 408(b) of the Code (collectively, "Tax-Favored Plans"). Certain employee benefit plans, such as governmental plans (as defined in Section 3(32) of ERISA), and, if no election has been made under Section 410(d) of the Code, church plans (as defined in Section 3(33) of ERISA), are not subject to ERISA requirements. Accordingly, assets of such plans may be invested in 2004 Series Bonds without regard to the ERISA considerations described below, subject to the provisions of applicable federal and state law. Any such plan which is a Qualified Retirement Plan and exempt from taxation under Sections 401(a) and 501(a) of the Code, however, is subject to the prohibited transaction rules set forth in the Code.

In addition to the imposition of general fiduciary requirements, including those of investment prudence and diversification and the requirement that a plan's investment be made in accordance with the documents governing the plan, Section 406 of ERISA and Section 4975 of the Code prohibit a broad range of transactions involving assets of ERISA Plans and Tax-Favored Plans and entities whose underlying assets include plan assets by reason of ERISA Plans or Tax-Favored Plans investing in such entities (collectively, "Benefit Plans") and persons who have certain specified relationships to the Benefit Plans ("Parties in Interest" or "Disqualified Persons"), unless a statutory or administrative exemption is available. Certain Parties in Interest (or Disqualified Persons) that participate in a prohibited transaction may be subject to a penalty (or an excise tax) imposed pursuant to Section 502(i) of ERISA (or Section 4975 of the Code) unless a statutory or administrative exemption is available.

Certain transactions involving the purchase, holding or transfer of the 2004 Series Bonds might be deemed to constitute prohibited transactions under ERISA and the Code if assets of MHESO were deemed to be assets of a Benefit Plan. Under a regulation issued by the United States Department of Labor (the "Plan Assets Regulation"), the assets of MHESO would be treated as plan assets of a Benefit Plan for the purposes of ERISA and the Code only if the Benefit Plan acquires an "equity interest" in MHESO and none of the exceptions contained in the Plan Assets Regulation is applicable. An equity interest is defined under the Plan Assets Regulation as an interest in an entity other than an instrument which is treated as indebtedness under applicable local law and which has no substantial equity features. Although there can be no assurances in this regard, it appears that the 2004 Series Bonds should be treated as debt without substantial equity features for purposes of the Plan Assets Regulation. However, without regard to whether the 2004 Series Bonds are treated as an equity interest for such purposes, the acquisition or holding of 2004 Series Bonds by or on behalf of a Benefit Plan could be considered to give rise to a prohibited transaction if MHESO or the Trustee, or any of their respective affiliates, is or becomes a party in interest or a disqualified person with respect to such Benefit Plan. In such case, certain exemptions from the prohibited transaction rules could be applicable depending on the type and circumstances of the plan fiduciary making the decision to acquire a Bond. Included among these exemptions are: Prohibited Transaction Class Exemption ("PTCE") 96-23, regarding transactions effected by "in-house asset managers"; PTCE 90-1, regarding investments by insurance company pooled separate accounts; PTE 95-60, regarding transactions effected by "insurance company general accounts"; PTCE 91-38, regarding investments by bank collective investment funds; and PTCE 84-14, regarding transactions effected by "qualified professional asset managers."

Any ERISA Plan fiduciary considering whether to purchase 2004 Series Bonds on behalf of an ERISA Plan should consult with its counsel regarding the applicability of the fiduciary responsibility and prohibited transaction provisions of ERISA and the Code to such investment and the availability of any of the exemptions referred to above. Persons responsible for investing the assets of Tax-Favored Plans that are not ERISA Plans should seek similar counsel with respect to the prohibited transaction provisions of the Code.

### ***Legal Opinions***

The 2004 Series Bonds will be approved as to legality and certain other matters by Best & Flanagan LLP, Minneapolis, Minnesota, as Bond Counsel to MHESO. All opinions with respect to enforceability of documents will contain an exception as to enforceability thereof being limited by State and federal laws, rulings and decisions affecting remedies and by bankruptcy, reorganization, moratorium or other laws of general application relating to or affecting enforcement of creditors' rights.

**MINNESOTA HIGHER EDUCATION SERVICES  
OFFICE**

**By: /s/ Susan G. Heegaard**

**Director**

**APPENDIX I**

**GENERAL PURPOSE FINANCIAL STATEMENTS OF THE  
MINNESOTA HIGHER EDUCATION SERVICES OFFICE**

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*Minnesota Higher  
Education Services  
Office*

*Financial Statements and Supplemental  
Schedules for the Years Ended June 30, 2003  
and 2002 and Independent Auditors' Report*

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

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## INDEPENDENT AUDITORS' REPORT

Minnesota Higher Education Services Council  
Saint Paul, Minnesota

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Minnesota Higher Education Services Office ("MHESO"), a component unit of the State of Minnesota, as of June 30, 2003 and 2002 and for the years then ended, which collectively comprise MHESO's basic financial statement as listed in the foregoing table of contents. These financial statements are the responsibility of MHESO'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, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of MHESO as of June 30, 2003 and 2002 and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The required supplementary information, such as management's discussion and analysis and budgetary comparison information on pages 2 through 8 and 28 through 33, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of MHESO'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.

In accordance with Government Auditing Standards, we have also issued a report dated September 19, 2003 on our consideration of MHESO's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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.

A handwritten signature in black ink that reads "Deloitte + Touche LLP".

September 19, 2003

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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Our discussion and analysis of the financial performance of Minnesota Higher Education Services Office (“MHESO”) provides an overview of MHESO’s financial activities for the fiscal year ended June 30, 2003.

### FINANCIAL HIGHLIGHTS

- MHESO’s net assets decreased \$24.7 million as a result of a \$30 million transfer to the State of Minnesota General Fund.
- In the 2001 first special session, the legislature had appropriated \$3,891,000 to be expended for agency administration in fiscal year 2003. In 2003, the agency administration funding was reduced by \$1,219,498 (including Professional/Technical contract and compensation savings) due to budget constraints, resulting in a 31% reduction from the original administrative funding.
- MHESO issued \$75 million in bonds to finance the increasing demand for student loans.
- Legislation increased MHESO’s maximum bonding authority from \$550 million to \$850 million.
- Because of the state’s current economic situation and budget deficit, the State of Minnesota implemented a “no hire” policy that was in effect through June 2003.
- MHESO received \$160.6 million for fiscal year 2003 appropriations. However, \$9.8 million was subsequently transferred to fiscal year 2002 to meet state grant obligations, and \$5.0 million was canceled to compensate for reduced state revenues.
- Because of students’ financial need for state student grants in fiscal year 2002 and the projected need in fiscal year 2003, \$19 million was transferred from the Work Study Program, Child Care Grant Program, and Interstate Tuition Reciprocity Program to the State Grant Program to partially meet this need. MHESO was required by law to make full State Grant awards to students in fiscal years 2002 and 2003.

### USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Combined Statements of Net Assets and the Combined Statement of Activities (on pages 9 and 10) provide information about the activities of MHESO as a whole and present a longer-term view of MHESO’s finances. Fund financial statements start on page 11. Fund financial statements also report MHESO’s operations in more detail than the government-wide statements by providing information about MHESO’s funds. The remaining statements provide financial information about activities for which MHESO acts solely as a trustee or agent for the benefit of those outside of the government.

### REPORTING MHESO AS A WHOLE

#### The Statements of Net Assets and the Statement of Activities

Our analysis of MHESO as a whole begins on page 4. The Combined Statements of Net Assets and the Combined Statement of Activities report information about MHESO as a whole and about its activities in a way that helps the reader grasp MHESO’s fiscal year 2003 financial activities. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies.

These statements report MHESO’s net assets and changes in them. You can think of MHESO’s net assets—the difference between assets and liabilities—as one way to measure MHESO’s financial health,

or financial position. Over time, increases or decreases in MHESO's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, to assess the overall health of MHESO.

In the Statements of Net Assets and the Statement of Activities, we divide MHESO into two kinds of activities:

- ***Governmental activities***—General appropriation funds are received by MHESO for the administration of postsecondary educational grant programs and the Work Study Program, administering the telecommunications council and the MnLink program, negotiating and administering reciprocity agreements, publishing and distributing financial aid information and materials, collecting and maintaining student enrollment and financial aid data, and administering various federal grant programs that affect students and postsecondary institutions. Licensing and registration fees finance the cost for administering the registration and licensing of private collegiate and career schools.
- ***Business-type activities***—MHESO is designated by statute as the administrative agency for the establishment of one or more loan programs. The purpose of the loan programs is to provide financial assistance for the postsecondary education of students. The two loan programs currently being administered by MHESO are the Student Educational Loan Fund (“SELF”) Program and the Graduated Repayment Income Protection (“GRIP”) Program.

## REPORTING MHESO'S MOST SIGNIFICANT FUNDS

### Fund Financial Statements

The fund financial statements begin on page 11 and provide detailed information about the most significant funds—not MHESO as a whole. Some funds are required to be established by state law, and MHESO established other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for certain grants and pass-through funds (like MINITEX payments to the Ohio College Library Center). MHESO's two kinds of funds—governmental and proprietary—use different accounting approaches.

- ***Governmental funds***—Most of MHESO's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of MHESO's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance MHESO's programs.
- ***Proprietary funds***—When MHESO charges customers for the services it provides—whether to outside customers or to other units of MHESO—these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statements of Net Assets and the Statement of Activities. In fact, MHESO's enterprise funds are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds.

## Reporting MHESO's Fiduciary Responsibilities

The State of Minnesota performs a fiduciary role for the Minnesota State Retirement System ("MSRS"), Teachers Retirement Association ("TRA"), and the Public Employees Retirement Association ("PERA"). MHESO contributes to the pension plans as an employer but does not act as trustee for any of the pension plans.

## MHESO AS A WHOLE

MHESO's combined net assets decreased by \$24.7 million. The analysis below focuses on the net assets (Table 1) and changes in net assets (Table 2) of MHESO's governmental and business-type activities.

**Table 1**  
**Net Assets**

	<b>2003</b>			<b>2002</b>		
	<b>Governmental Activities</b>	<b>Business-Type Activities</b>	<b>Total Primary Government</b>	<b>Governmental Activities</b>	<b>Business-Type Activities</b>	<b>Total Primary Government</b>
Assets:						
Current and other assets	\$ 7,617,142	\$ 572,617,672	\$ 580,234,814	\$ 10,840,917	\$ 522,658,821	\$ 533,499,738
Capital assets, net	<u>64,556</u>	<u>8,419</u>	<u>72,975</u>	<u>94,867</u>	<u>14,175</u>	<u>109,042</u>
Total assets	7,681,698	572,626,091	580,307,789	10,935,784	522,672,996	533,608,780
Liabilities:						
Other liabilities	7,142,945	1,196,085	8,339,030	10,453,477	974,125	11,427,602
Revenue bonds	<u>                    </u>	<u>297,913,035</u>	<u>297,913,035</u>	<u>                    </u>	<u>223,428,256</u>	<u>223,428,256</u>
Total liabilities	7,142,945	299,109,120	306,252,065	10,453,477	224,402,381	234,855,858
Net assets:						
Invested in capital assets	64,556	8,419	72,975	94,867	14,175	109,042
Restricted for debt service		273,508,552	273,508,552		22,412,905	22,412,905
Unrestricted	<u>474,197</u>	<u>                    </u>	<u>474,197</u>	<u>387,440</u>	<u>275,843,535</u>	<u>276,230,975</u>
Total net assets	<u>\$ 538,753</u>	<u>\$ 273,516,971</u>	<u>\$ 274,055,724</u>	<u>\$ 482,307</u>	<u>\$ 298,270,615</u>	<u>\$ 298,752,922</u>

Net assets of MHESO's governmental activities increased by \$56,446 during the current fiscal year versus \$68,469 during the prior fiscal year. State appropriations are reserved for the portion of severance liability and retired employees insurance benefits liability that MHESO has at fiscal year-end.

Unrestricted net assets—the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements—increased from \$387,440 at June 30, 2002 to \$474,197 at the end of this year.

The excess of revenues over expenses of MHESO's business-type activities increased by \$5.2 million in fiscal year 2003, which was 39.0% of expenditures. The previous year's increase of 98.8% of expenditures was the result of net revenues exceeding program expenses.

**Table 2**  
**Changes in Net Assets**

	<b>2003</b>			<b>2002</b>		
	<b>Governmental Activities</b>	<b>Business-Type Activities</b>	<b>Total Primary Government</b>	<b>Governmental Activities</b>	<b>Business-Type Activities</b>	<b>Total Primary Government</b>
REVENUES -						
Program revenues:						
Charges for services	\$ 356,335	\$ 18,688,622	\$ 19,044,957	\$ 270,025	\$ 23,760,282	\$ 24,030,307
State appropriations	149,667,275		149,667,275	164,453,791		164,453,791
Federal appropriations	<u>4,754,702</u>		<u>4,754,702</u>	<u>3,750,311</u>		<u>3,750,311</u>
Total revenues	154,778,312	18,688,622	173,466,934	168,474,127	23,760,282	192,234,409
PROGRAM EXPENSES:						
General government	6,071,647	7,462,046	13,533,693	8,176,355	6,519,255	14,695,610
Tuition reciprocity	127,850		127,850	3,083,656		3,083,656
State and other grants	145,061,360		145,061,360	154,287,934		154,287,934
Federal grants	3,087,050		3,087,050	1,930,353		1,930,353
Intergovernmental transfer	373,959		373,959	927,360		927,360
Provision for loan losses, net		2,502,666	2,502,666		1,823,180	1,823,180
Amortization		54,308	54,308		42,568	42,568
Interest expense		<u>3,423,246</u>	<u>3,423,246</u>		<u>3,565,570</u>	<u>3,565,570</u>
Total expenses	<u>154,721,866</u>	<u>13,442,266</u>	<u>168,164,132</u>	<u>168,405,658</u>	<u>11,950,573</u>	<u>180,356,231</u>
EXCESS OF REVENUE OVER EXPENSES	56,446	5,246,356	5,302,802	68,469	11,809,709	11,878,178
TRANSFER TO STATE OF MINNESOTA GENERAL FUND		<u>(30,000,000)</u>	<u>(30,000,000)</u>			
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	<u>\$ 56,446</u>	<u>\$ (24,753,644)</u>	<u>\$ (24,697,198)</u>	<u>\$ 68,469</u>	<u>\$ 11,809,709</u>	<u>\$ 11,878,178</u>

MHESO's total revenues decreased \$18.8 million (or 9.8%). Net business program revenue was consistent with the historical trend.

### **Governmental Activities**

Revenues for MHESO's governmental activities (see Table 2) decreased by \$13.7 million (or 8.1%), while total expenses decreased by \$13.7 million (or 8.1%). The majority of the governmental activities revenue decrease was due to the Work Study Program and MINITEX library services.

- \$118.5 million was originally appropriated for the State Grant Program. This amount has been increased by almost \$13.5 million to \$132 million, with a transfer of funds originally appropriated for tuition reciprocity, child care grants, and work study, to meet the increased demand of qualified recipients.

## **Business-Type Activities**

Revenues of MHESO's business-type activities (see Table 2) decreased by 21.3% (\$23,760,282 in 2002 compared to \$18,688,622 in 2003) and expenses increased by 12.5%. The factors driving these results include:

- In June 2003, MHESO issued \$75 million in bonds to finance the increased demand for student loans.
- The current interest rate charged to SELF I and SELF II program student loans is set at a record low rate of 4.25 and 3.0%, respectfully. The SELF III rate is currently set at 4.2%. The SELF III program bases the interest rate charged to borrowers on the average of the three-month London Interbank Offered Rates ("LIBOR") during the calendar quarter immediately preceding the interest rate adjustment date.
- As shown in the Statement of Cash Flows, the financing of operating activities was only partially offset with cash provided by noncapital financing activities. Investment activity provided additional cash by reinvesting investment maturities to very short terms of less than three months, thereby qualifying as cash equivalents.

## **Governmental Funds Budgetary Highlights**

Over the course of the year, changes were made to the MHESO budget. The other operating costs' budget decreased \$5.0 million. The other payments to individuals budget increased by over \$1.2 million and aid to higher education institutions budget increased by over \$3.3 million.

Even with these adjustments, the actual charges to appropriations (expenditures) were \$2.1 million below the final budget amounts. The most significant positive variance occurred in aid to nongovernmental organizations where most current-year payments went to higher education institutions.

## **CASH MANAGEMENT**

Unexpended general appropriated funds are invested pursuant to Minnesota Statutes 11A under the State Board of Investments. Monies in the Loan Capital Fund are managed by MHESO and invested in instruments allowed by state statute, such as U.S. Treasury bills and notes, general obligation municipals, collateralized certificates of deposit, repurchase agreements, federal agency notes, bankers' acceptances, and commercial paper. MHESO's investment policy prohibits MHESO from investing in instruments with maturities in excess of three years. The total Investment Income, including change in the fair value of investments, was down from 2002 by \$913,936. As of June 30, 2003, the fair value of MHESO's investments was greater than cost by \$9,249. MHESO's policy is to hold all securities until maturity; therefore, it is highly unlikely that any differences between cost and market in investments would be realized. All of MHESO's investment securities are held in trust in MHESO's name.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### Capital Assets

At the end of 2003, MHESO had \$72,975 invested in equipment (shown net of depreciation in Table 3 below). MHESO does not own any land or building capital assets. In fiscal year 2000, MHESO adopted the State of Minnesota's valuation for capital assets to include only equipment purchased for \$10,000 or more unless specific grant or other funding sources require a lower capitalization threshold. More detailed information about MHESO's capital assets is presented in Note 5 to the financial statements.

**Table 3**  
**Capital Assets at Year-End**  
**(Net of Depreciation)**

	<b>2003</b>			<b>2002</b>		
	<b>Governmental Activities</b>	<b>Business- Type Activities</b>	<b>Total Primary Government</b>	<b>Governmental Activities</b>	<b>Business- Type Activities</b>	<b>Total Primary Government</b>
Equipment	\$ 64,556	\$ 8,419	\$ 72,975	\$ 94,867	\$ 14,175	\$ 109,042

### Debt

At year-end, MHESO had \$297.9 million in bonds and notes outstanding—as shown in Table 4 (net of \$2,086,965 of deferred issuance costs).

**Table 4**  
**Outstanding Debt at Year-End**  
**(in Millions)**

	<b>2003</b>			<b>2002</b>		
	<b>Governmental Activities</b>	<b>Business- Type Activities</b>	<b>Total Primary Government</b>	<b>Governmental Activities</b>	<b>Business- Type Activities</b>	<b>Total Primary Government</b>
Revenue bonds	\$ -	\$ 297.9	\$ 297.9	\$ -	\$ 223.4	\$ 223.4

Since 1984, MHESO's revenue bond rating has been AAA, the highest rating possible.

Other obligations of MHESO include accrued vacation pay and sick leave, which are included in accounts payable and accrued liabilities on the balance sheet. More detailed information about MHESO's long-term liabilities is presented in Note 6 to the financial statements.

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

MHESO's officials considered many factors when setting the fiscal year 2003 budget, rates, and fees that will be charged for the business-type activities. One of the factors is the current trend within the economy. Student loan borrowing has greatly increased within the past few years. This increase has required MHESO to seek additional funding through the issuance of taxable bonds. The current SELF II loan program margin rate is set at 2.0%, the highest margin allowed under the SELF II Loan program, to compensate for the additional interest cost and other charges associated with the taxable bonds. In fiscal year 2002, MHESO received approval for the SELF III program that bases the interest rate charged to borrowers on the average of the three-month LIBOR during the calendar quarter immediately preceding

the interest rate adjustment date plus a margin. The current SELF III margin is 3.0%. SELF III loan disbursements began in May 2002. MHESO also received approval to establish other rates or utilize a fixed rate when terms can be obtained at a favorable rate to borrowers.

Minnesota Statutes 2002 Section 136A.01, subdivision 1, was amended to change the appointment of the agency director to a governor appointee position, with the advice and consent of the senate.

Careful consideration was given to legislative goals and the agency's mission when adopting the General Fund budget for fiscal year 2004. Tuition increases for fiscal 2004 at Minnesota public colleges are approximately 15% with double-digit increases also expected in 2005. Due to an increased need for student grants, MHESO was appropriated an additional \$20 million by the legislature to the State Grant Program for fiscal year 2004. The private tuition maximums used in the state grant formula remained the same as the fiscal year 2003 maximum of \$8,983 for four-year institutions and \$6,913 for two-year institutions. Grant awards are based on the lesser of the average tuition and fees charged by the institution for the term, or the maximum established by law.

In fiscal year 2003, the State Grant Program was allowed to use Child Care Grant and Work Study Program appropriations if the State Grant Program had a projected need. In fiscal year 2004, if there is an insufficient appropriation, the awards will be reduced by adding a surcharge to the family responsibility and a percentage to the student's responsibility. In addition, a deadline of 14 days after the start of a term has been established for the office to accept applications for state grants. State grant awards are limited to eight semesters or the school equivalent, reduced from ten semesters.

The maximum postsecondary Child Care Grant is \$2,200 in fiscal year 2004, reduced from \$2,600 in fiscal year 2003.

Funds were eliminated for the Summer Scholarship program which was \$200,000 in 2002.

In the 2001 first special session, the legislature had appropriated \$3,891,000 for agency administration in fiscal year 2003. The fiscal year 2004 agency administration funding has been reduced to \$2,860,000, resulting in a 26% reduction from the fiscal year 2003 original appropriation.

MHESO plans a new bond issuance in fiscal year 2004. The Supplemental Indenture for the 2003A and 2003B Series was modified to include limitations on the use of funds in the Loan Capital Fund if the net worth falls below \$275,000,000 as June 30, 2003, with incremental increases thereafter. This increase in net worth requirement is vital to serve the demand for student loans. Current outstanding bonds rely on the Loan Capital Fund for the payment of defaulted student loans pledged as collateral and various bond fees, servicing costs, and administrative expenses.

## **CONTACTING MHESO'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, customers, and creditors with a general overview of MHESO's finances and to show MHESO's accountability for the money it receives. If you have questions about this report or need additional financial information, contact MHESO at (651) 642-0519.



# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## COMBINED STATEMENTS OF NET ASSETS JUNE 30, 2003 AND 2002

	2003			2002		
	Primary Government			Primary Government		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
ASSETS:						
Cash and cash equivalents (Note 4)	\$ 6,341,661	\$ 135,184,881	\$ 141,526,542	\$ 8,756,374	\$ 51,306,188	\$ 60,062,562
Designated cash equivalents (Notes 2 and 4)		4,417,656	4,417,656		4,030,617	4,030,617
Investments (Note 4)					89,918,654	89,918,654
Receivables, net	1,275,481	433,015,135	434,290,616	2,084,543	377,403,362	379,487,905
Capital assets, net (Note 5)	<u>64,556</u>	<u>8,419</u>	<u>72,975</u>	<u>94,867</u>	<u>14,175</u>	<u>109,042</u>
Total assets	7,681,698	572,626,091	580,307,789	10,935,784	522,672,996	533,608,780
LIABILITIES:						
Accounts payable and accrued liabilities	4,287,589	1,196,085	5,483,674	3,708,846	974,125	4,682,971
Deferred revenue	2,855,356		2,855,356	6,744,631		6,744,631
Revenue bonds (Note 6)		<u>297,913,035</u>	<u>297,913,035</u>		<u>223,428,256</u>	<u>223,428,256</u>
Total liabilities	7,142,945	299,109,120	306,252,065	10,453,477	224,402,381	234,855,858
NET ASSETS:						
Invested in capital assets	64,556	8,419	72,975	94,867	14,175	109,042
Restricted for debt service		273,508,552	273,508,552		22,412,905	22,412,905
Unrestricted	<u>474,197</u>		<u>474,197</u>	<u>387,440</u>	<u>275,843,535</u>	<u>276,230,975</u>
Total net assets	<u>\$ 538,753</u>	<u>\$ 273,516,971</u>	<u>\$ 274,055,724</u>	<u>\$ 482,307</u>	<u>\$ 298,270,615</u>	<u>\$ 298,752,922</u>

See notes to financial statements.

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## COMBINED STATEMENT OF ACTIVITIES YEAR ENDED JUNE 30, 2003

	Expenses	Program Revenues		Net Revenue (Expense) and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Primary Government		Total
				Governmental Activities	Business- Type Activities	
PRIMARY GOVERNMENT:						
Governmental activities:						
State appropriations	\$ 149,697,586		\$ 149,667,275	\$ (30,311)		\$ (30,311)
Federal appropriations	5,024,280		4,754,702	(269,578)		(269,578)
Registration and licensing fees and other		\$ 356,335		356,335		356,335
Total governmental activities	154,721,866	356,335	154,421,977	56,446		56,446
Business-type activities—						
Loan fund	13,442,266	18,688,622			\$ 5,246,356	5,246,356
Total primary government	<u>\$ 168,164,132</u>	<u>\$ 19,044,957</u>	<u>\$ 154,421,977</u>	56,446	5,246,356	5,302,802
Transfer to State of Minnesota General Fund (Note 9)					(30,000,000)	(30,000,000)
CHANGE IN NET ASSETS				56,446	(24,753,644)	(24,697,198)
NET ASSETS—Beginning of year				<u>482,307</u>	<u>298,270,615</u>	<u>298,752,922</u>
NET ASSETS—End of year				<u>\$ 538,753</u>	<u>\$ 273,516,971</u>	<u>\$ 274,055,724</u>

## COMBINED STATEMENT OF ACTIVITIES YEAR ENDED JUNE 30, 2002

			Net Revenue (Expense) and Changes in Net Assets			
			Primary Government			
	Expenses	Program Revenues				
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business- Type Activities	Total
PRIMARY GOVERNMENT:						
Governmental activities:						
State appropriations	\$ 164,444,004		\$ 164,453,791	\$ 9,787		\$ 9,787
Federal appropriations	3,961,654		3,750,311	(211,343)		(211,343)
Registration and licensing fees and other		\$ 270,025		270,025		270,025
Total governmental activities	168,405,658	270,025	168,204,102	68,469		68,469
Business-type activities -						
Loan fund	11,950,573	23,760,282			\$ 11,809,709	11,809,709
Total primary government	<u>\$ 180,356,231</u>	<u>\$ 24,030,307</u>	<u>\$ 168,204,102</u>	68,469	11,809,709	11,878,178
NET ASSETS—Beginning of year				413,838	286,460,906	286,874,744
NET ASSETS—End of year				<u>\$ 482,307</u>	<u>\$ 298,270,615</u>	<u>\$ 298,752,922</u>

See notes to financial statements.

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## BALANCE SHEETS GOVERNMENTAL FUND TYPES JUNE 30, 2003 AND 2002

	<u>2003</u>			<u>2002</u>		
	General	Special Revenue	Total	General	Special Revenue	Total
<b>ASSETS</b>						
Cash and cash equivalents	\$ 5,839,623	\$ 502,038	\$ 6,341,661	\$ 8,338,134	\$ 418,240	\$ 8,756,374
Receivables, net	641,908	633,573	1,275,481	1,347,886	736,657	2,084,543
Capital assets, net	<u>64,556</u>	<u></u>	<u>64,556</u>	<u>94,867</u>	<u></u>	<u>94,867</u>
Total assets	<u>\$ 6,546,087</u>	<u>\$ 1,135,611</u>	<u>\$ 7,681,698</u>	<u>\$ 9,780,887</u>	<u>\$ 1,154,897</u>	<u>\$ 10,935,784</u>
<b>LIABILITIES AND FUND BALANCES</b>						
<b>LIABILITIES:</b>						
Accounts payable and accrued liabilities	\$ 3,626,175	\$ 661,414	\$ 4,287,589	\$ 2,941,389	\$ 767,457	\$ 3,708,846
Deferred revenue	<u>2,855,356</u>	<u></u>	<u>2,855,356</u>	<u>6,744,631</u>	<u></u>	<u>6,744,631</u>
Total liabilities	6,481,531	661,414	7,142,945	9,686,020	767,457	10,453,477
<b>FUND BALANCES:</b>						
Invested in capital assets	64,556		64,556	94,867		94,867
Unrestricted	<u></u>	<u>474,197</u>	<u>474,197</u>	<u></u>	<u>387,440</u>	<u>387,440</u>
Total fund balances	<u>64,556</u>	<u>474,197</u>	<u>538,753</u>	<u>94,867</u>	<u>387,440</u>	<u>482,307</u>
Total liabilities and fund balances	<u>\$ 6,546,087</u>	<u>\$ 1,135,611</u>	<u>\$ 7,681,698</u>	<u>\$ 9,780,887</u>	<u>\$ 1,154,897</u>	<u>\$ 10,935,784</u>

See notes to financial statements.

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES GOVERNMENTAL FUND TYPES YEARS ENDED JUNE 30, 2003 AND 2002

	<u>2003</u>			<u>2002</u>		
	<u>General</u>	<u>Special Revenue</u>	<u>Total</u>	<u>General</u>	<u>Special Revenue</u>	<u>Total</u>
REVENUES:						
State appropriations	\$ 149,667,275		\$ 149,667,275	\$ 164,453,791		\$ 164,453,791
Federal appropriations		\$ 4,754,702	4,754,702		\$ 3,750,311	3,750,311
Registration and licensing fees		140,308	140,308		145,630	145,630
Other revenue		<u>216,027</u>	<u>216,027</u>		<u>124,395</u>	<u>124,395</u>
Total revenues	149,667,275	5,111,037	154,778,312	164,453,791	4,020,336	168,474,127
EXPENDITURES:						
General government	4,134,417	1,937,230	6,071,647	6,145,054	2,031,301	8,176,355
Tuition reciprocity	127,850		127,850	3,083,656		3,083,656
State and other grants	145,061,360		145,061,360	154,287,934		154,287,934
Federal grants		3,087,050	3,087,050		1,930,353	1,930,353
Intergovernmental transfer	<u>373,959</u>		<u>373,959</u>	<u>927,360</u>		<u>927,360</u>
Total expenditures	<u>149,697,586</u>	<u>5,024,280</u>	<u>154,721,866</u>	<u>164,444,004</u>	<u>3,961,654</u>	<u>168,405,658</u>
(DEFICIT) EXCESS OF REVENUES OVER EXPENDITURES	(30,311)	86,757	56,446	9,787	58,682	68,469
FUND BALANCE— Beginning of year	<u>94,867</u>	<u>387,440</u>	<u>482,307</u>	<u>85,080</u>	<u>328,758</u>	<u>413,838</u>
FUND BALANCE— End of year	<u>\$ 64,556</u>	<u>\$ 474,197</u>	<u>\$ 538,753</u>	<u>\$ 94,867</u>	<u>\$ 387,440</u>	<u>\$ 482,307</u>

See notes to financial statements.

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS PROPRIETARY FUND TYPES YEARS ENDED JUNE 30, 2003 AND 2002

	2003	2002
OPERATING REVENUES:		
Interest on student loans	\$ 16,890,363	\$ 21,045,528
United States Government interest allowance (Note 3)	<u>6,711</u>	<u>9,270</u>
Total operating revenues	16,897,074	21,054,798
OPERATING EXPENSES:		
General and administrative expenses	7,462,046	6,519,255
Provision for loan losses, net (Note 3)	2,502,666	1,823,180
Amortization	<u>54,308</u>	<u>42,568</u>
Total operating expenses	<u>10,019,020</u>	<u>8,385,003</u>
OPERATING INCOME	6,878,054	12,669,795
NONOPERATING REVENUES (EXPENSES):		
Investment income	1,791,548	2,705,484
Interest expense	<u>(3,423,246)</u>	<u>(3,565,570)</u>
Total nonoperating expenses, net	<u>(1,631,698)</u>	<u>(860,086)</u>
EXCESS OF REVENUE OVER EXPENSES	5,246,356	11,809,709
TRANSFER TO STATE OF MINNESOTA GENERAL FUND (Note 9)	<u>(30,000,000)</u>	
(DECREASE) INCREASE IN NET ASSETS	(24,753,644)	11,809,709
NET ASSETS—Beginning of year	<u>298,270,615</u>	<u>286,460,906</u>
NET ASSETS—End of year	<u>\$ 273,516,971</u>	<u>\$ 298,270,615</u>

See notes to financial statements.

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## STATEMENTS OF CASH FLOWS PROPRIETARY FUND TYPES YEARS ENDED JUNE 30, 2003 AND 2002

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from loan holders	\$ 66,502,948	\$ 69,111,591
Cash paid for loan origination	(107,205,120)	(104,463,017)
Cash paid to employees and suppliers	(7,778,754)	(7,000,833)
Interest received	2,133,876	3,300,381
Interest paid	<u>(3,379,015)</u>	<u>(3,518,166)</u>
Net cash used in operating activities	(49,726,065)	(42,570,044)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(87,863,636)	(275,135,019)
Proceeds from maturity of investments	<u>177,424,962</u>	<u>245,812,337</u>
Net cash provided by (used in) investing activities	89,561,326	(29,322,682)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from bonds	75,000,000	95,300,000
Bond issuance costs	(569,529)	(726,684)
Transfer to State of Minnesota General Fund	<u>(30,000,000)</u>	<u></u>
Net cash provided by noncapital financing activities	<u>44,430,471</u>	<u>94,573,316</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	84,265,732	22,680,590
CASH AND CASH EQUIVALENTS—Beginning of year	<u>55,336,805</u>	<u>32,656,215</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 139,602,537</u>	<u>\$ 55,336,805</u>
RECONCILIATION OF NET INCOME TO NET CASH USED IN OPERATING ACTIVITIES:		
Increase in excess of revenue over expenses	\$ 5,246,356	\$ 11,809,709
Adjustments to reconcile excess of revenue over expenses to net cash used in operating activities:		
Depreciation and amortization	60,064	48,396
Decrease in fair value of investments	357,328	594,896
Provision for loan loss	5,823,648	4,616,539
Write-off of loans	(5,436,609)	(3,939,146)
Origination of student loans	(107,205,120)	(104,463,017)
Principal payments on student loans	50,253,236	48,913,911
Changes in assets and liabilities:		
Decrease in interest receivable	661,483	324,054
Decrease (increase) in other receivable	291,589	(548,350)
Increase in accounts payable and accruals	<u>221,960</u>	<u>72,964</u>
Net cash used in operating activities	<u>\$ (49,726,065)</u>	<u>\$ (42,570,044)</u>

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2003 AND 2002

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### 1. BASIS OF PRESENTATION

***Nature of Organization***—Effective July 1, 1995, the Minnesota Higher Education Services Office (“MHESO”) was created in accordance with laws of Minnesota for 1995 as a component unit of the State of Minnesota. MHESO is responsible for the administration of State of Minnesota financial aid programs to students enrolled in eligible postsecondary institutions. In addition, MHESO is also responsible for administering federal financial aid programs that affect eligible students and institutions on a statewide basis. A Higher Education Services Council, with nine members appointed by the governor, was also created to oversee the performance of MHESO in its duties.

***Government-Wide Basis of Presentation***—The government-wide financial statements (i.e., the statements of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of MHESO. Governmental activities, which are supported primarily by state appropriations and federal grants, are reported separately from business-type activities, which rely to a significant extent on fees and charges from student loans.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and (2) grants and contributions that are restricted to meeting the operational requirements of a particular function.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

***Fund Accounting Basis of Presentation***—The financial statements are presented in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). In accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*, MHESO’s financial statements are presented discretely in the State of Minnesota’s Comprehensive Annual Financial Report as a component unit. The accounts of MHESO are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses, as appropriate. Government resources are allocated and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped, in the financial statements

in this report, into three generic fund types and two broad fund types. A description of the fund types and account groups used by MHESO follows.

***Governmental Fund Types***—The focus of Governmental Fund measurement is on the determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than on net income. The following is a description of the Governmental Funds used by MHESO:

*General Fund*—The General Fund is the general operating fund of MHESO. It is used to account for all financial resources except those required to be accounted for in another fund. In addition, the General Fund is used to account for the funds received and disbursed for the State of Minnesota financial aid programs.

*Special Revenue Funds*—Special Revenue Funds are used to account for the proceeds of specific revenue sources requiring separate accounting because of legal, regulatory, grant provisions or administrative action. They include the Miscellaneous Grant and Federal Grant Funds. The Miscellaneous Grant Fund receives and disburses grant funds received from private sources under private financial aid programs. The Federal Grant Fund receives and disburses federal government grants and reimbursements under the federal financial aid programs. The Federal Grant Fund is administered in accordance with grant agreements between MHESO and the federal agencies.

*Proprietary Fund Types*—The focus of Proprietary Fund measurement is on the determination of operating income, changes in net assets, financial position, and cash flows. The generally accepted accounting principles applicable are those similar to businesses in the private sector. MHESO's sole Proprietary Fund is the Loan Capital Fund ("LCF") (see Note 3).

*Agency Funds*—Agency Funds are used to account for funds that are held in a custodial capacity. A contract has been established with the Online Computer Library Center ("OCLC") to provide a system for computer-shared cataloging and/or other library services to MINITEX library participants. The MINITEX Library Program is designed to facilitate improved coordination and sharing of library resources. MHESO receives funds from the University of Minnesota, the State of North Dakota, and the State of South Dakota for the payment of OCLC charges.

Information relating to this agency fund is presented in the required supplementary information on pages 28 and 29, and is not presented in the financial statements.

***Reclassifications***—Certain reclassifications have been made to the 2002 financial statements to conform to the classifications used in 2003. The reclassifications had no net effect on the net assets or statement of activities as previously reported.

## **2. BASIS OF ACCOUNTING AND BASIS OF PRESENTATION**

***Basis of Accounting***—The basis of accounting refers to the time at which revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. The basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

All Governmental Funds are accounted for using the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. Available means collectible within the current period or soon enough thereafter to pay current liabilities of the



current period. For this purpose, MHESO considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are generally recognized under the modified accrual basis of accounting when the related liability is incurred, as under accrual accounting.

Proprietary Funds are accounted for using the accrual basis of accounting. Their revenues are recognized when they are earned, and their expenses are recognized when they are incurred. All applicable GASB pronouncements have been applied to Proprietary Funds. Additionally, the following pronouncements issued on or before November 30, 1989 have been applied unless those pronouncements conflict with or contradict GASB: Statements and Interpretations of the Financial Accounting Standards Board, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

***Cash and Cash Equivalents***—MHESO considers cash on hand, demand deposits, and highly liquid investments with a maturity at date of purchase of three months or less to be cash equivalents.

***Designated Cash Equivalents***—These amounts represent funds maintained with the Minnesota Department of Finance and are designated by MHESO to cover loan losses of the LCF.

***Investments***—In accordance with GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, MHESO reports investments at fair value in the combined statement of net assets. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value of investments was determined based on quoted market prices as of the reporting date.

***Liabilities***—Governmental Fund types record only short-term liabilities of the funds. Proprietary Fund types record both long- and short-term liabilities of the fund.

***Sick Pay, Severance Pay, and Vacation Pay***—MHESO's employee vacation and sick leave policies provide for granting of a specific number of days for unused sick leave upon retirement if certain conditions are met. This pay is vested when earned. In accordance with GASB No. 16, *Accounting for Compensated Absences*, sick pay that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a liability of the Governmental Fund that will pay it.

MHESO offers to its employees sick pay, which accrues at various rates depending on classification of employment. Employees are not compensated for unused sick leave upon termination; however, unused sick leave enters into the computation of severance pay. Sick pay is charged as an expenditure as accrued.

All employees who have provided 5 to 20 years or more, depending on employment contract terms, of continuous State of Minnesota service are entitled to receive severance pay upon any separation, except discharge for just cause from service. Severance is calculated based upon a formula using an employee's unused sick leave balance. Severance pay is charged as an expenditure as earned.

MHESO records vacation pay for applicable employees when the employees' rights to receive compensation are attributable to services already rendered and it is probable that MHESO will compensate the employees through paid time off or some other means. All eligible employees accrue vacation at a rate that varies with length of service. Any employee who has been employed

more than six months and who has separated from State of Minnesota service is compensated in cash at his or her current rate at the time of separation. However, no payment shall exceed 280 hours, except in the case of death.

**Revenues and Deferred Revenue**—Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). “Measurable” means the amount of the transaction can be determined, and “available” means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. State revenues are recognized in the year designated by Minnesota Statutes. Federal revenues are recognized in the year during which the eligible expenditures are made. If the amounts of state or federal revenues cannot be reasonably estimated, or realization is not reasonably assured, they are not recognized as revenue in the current year.

MHESO reports deferred revenue on its combined statement of net assets. Deferred revenues arise when a potential revenue does not meet both the “measurable” and “available” criteria for recognition in the current period. Deferred revenues also arise when resources are received by MHESO before it has a legal claim to them, as when grant monies are received prior to the incurred qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met or when MHESO has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized.

**Income Taxes**—MHESO is an agency of the State of Minnesota and is exempt from federal and state income taxes. Accordingly, no provision for income taxes is necessary.

**Use of Estimates**—The presentation of financial statements in accordance 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 revenues and expenditures during the reporting period. Actual results could differ from those estimates. MHESO invests in various securities, including U.S. Government securities, corporate debt instruments, and corporate stocks. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the combined statements of net assets.

### **3. LOAN CAPITAL FUND**

The LCF, the Enterprise Fund of MHESO, is dedicated to supporting MHESO’s student loan activities, both present and future, including and without limitation: the Guaranteed Student Loan Program (“GSL”), Supplemental Loan programs (“SELF I, SELF II, and SELF III”), Graduated Repayment Loan programs (“GRIP”), and payment of expenses of administering such programs. MHESO is authorized to issue an aggregate amount of outstanding revenue bonds, exclusive of refunded and defeased bonds, of \$850,000,000 and \$550,000,000 at June 30, 2003 and 2002, respectively. Bonds issued do not constitute debt of the State of Minnesota.

**Deferred Loan Costs**—In accordance with Statement of Financial Accounting Standards No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, SELF II, SELF III, and GRIP loans are reported at the principal amount outstanding plus the unamortized amount of costs incurred to originate the loans. The origination costs are amortized over the average life of the loans as a reduction of yield. Interest

income is recognized at a constant rate over the life of the loans. For SELF I loans, the origination costs are being deferred and the net amount amortized using a method that approximates the effective interest method. Amortization of total deferred loan costs for the years ended June 30, 2003 and 2002 were \$424,259 and \$395,702, respectively.

**Receivables**—Receivables for MHESO's Loan Capital Fund, including the applicable allowances for uncollectible accounts for the years ended June 30, 2003 and 2002, are as follows:

	2003	2002
Loans	\$ 435,044,048	\$ 378,092,164
Interest	1,732,476	2,393,959
Other	<u>656,267</u>	<u>947,856</u>
Gross receivables	437,432,791	381,433,979
Less allowance for uncollectibles	<u>(4,417,656)</u>	<u>(4,030,617)</u>
Receivables, net	<u>\$ 433,015,135</u>	<u>\$ 377,403,362</u>

Loans receivable includes amounts due within one year and amounts due in more than one year, based upon loan schedules with each student (loan holder). Approximately 15% of the balance is expected to be collected during fiscal year 2004.

**Loans Receivable**—GSL loans were made to students who met certain eligibility requirements under the Federal Higher Education Act of 1965, as amended. Loans bear interest at 7% to 9% annually. MHESO is no longer issuing new GSL loans to students. Interest on student loans is paid quarterly by the U.S. Government prior to the commencement of repayment by the student or during a repayment deferral period. Repayment of principal and interest by students commences within six months to one year following termination of at least a half-time academic workload. The balance at June 30, 2003 and 2002 was \$749,175 and \$1,038,569, respectively.

SELF I loans are no longer being issued by MHESO. The only activity is loan repayments. The rate was 4.25% as of June 30, 2003 and 2002.

SELF II loans are made to students who meet the eligibility requirements set forth by MHESO. The interest rate on the loans is equal to the average of the weekly auction average (investment) interest rate on three-month Treasury bills plus a current margin of 2.0%. The interest rate cannot change more than two percentage points in any four consecutive calendar quarters. The rate was 3.25% and 5% as of June 30, 2003 and 2002, respectively.

SELF III loans, offered for the first time in May of 2002, are made to students who meet the eligibility requirements set forth by MHESO. The interest rate on the loans is equal to the LIBOR plus a current margin of 2.7%. The interest rate cannot change more than three percentage points in any four consecutive calendar quarters. The rate was 4.3% and 4.6% as of June 30, 2003 and 2002, respectively.

Repayment of interest for SELF loans begins 90 days after disbursement and is due quarterly thereafter. Principal payments begin no later than 36 months after graduation or termination. The balance of SELF I, SELF II, and SELF III loans at June 30, 2003 and 2002 was \$431,257,183 and \$373,002,063, respectively.

GRIP loans were made to borrowers who met certain income and debt standards and had graduated with an eligible medical degree. The LCF makes the required monthly payments on the borrower's student loans, and the borrower makes monthly payments to MHESO based on the average income for their medical profession. The borrower's loan payments increase annually in proportion to the growth of the average income for their profession. The interest rate on GRIP loans is fixed at 8%. MHESO is no longer issuing GRIP loans to new participants. The balance at June 30, 2003 and 2002 was \$3,037,690 and \$4,051,532, respectively.

Included in general and administrative expenses are fees paid to a third-party service corporation to administer and service the student loans of \$4,921,988 and \$4,385,820 for the years ended June 30, 2003 and 2002, respectively.

**Cash Reserve on Loans**—GSL loans, and the accrued interest thereon, are fully guaranteed by Great Lakes Higher Education Guaranty Corp. ("Great Lakes"). Great Lakes is a nonprofit agency, which has been designated as the guarantee agency for the State of Minnesota. Loans guaranteed by Great Lakes are reinsured by the U.S. Government. Therefore, an allowance for uncollectible loans has not been provided.

An allowance for uncollectible SELF I, SELF II and SELF III loans is provided for in the financial statements, and an equal amount of the allowance is maintained as designated cash equivalents in the LCF. For loans with loan periods beginning before July 1, 1989, an amount equal to 6.25% of the original loan balance was collected from the students. For loans with loan periods beginning on or after July 1, 1989, the LCF provides for loan losses sufficient to maintain the total balance in the allowance at a level equal to 1% of the total outstanding loan balance and also designates cash equivalents equal to the balance of the allowance. An allowance for uncollectible GRIP loans equal to 4% of the total outstanding loan balance is maintained as designated cash equivalents in the LCF. The designated cash has been deposited with the Minnesota Department of Finance. Recoveries on defaulted SELF loans are credited to the LCF as revenue in the year received.

The activity for the allowance for losses on all loan types for the years ended June 30, 2003 and 2002 is as follows:

	2003	2002
Beginning balance	\$ 4,030,617	\$ 3,353,224
Provision for loan losses	5,823,648	4,616,539
Write-off of loans	<u>(5,436,609)</u>	<u>(3,939,146)</u>
Ending balance	<u>\$ 4,417,656</u>	<u>\$ 4,030,617</u>

Recovery on defaulted loans of \$3,320,982 and \$2,793,359 for the years ended June 30, 2003 and 2002, respectively, are recognized as a reduction in the provision for loan losses and are not reflected in the above table.

**United States Government Allowance**—The U.S. Government pays the LCF a special interest allowance quarterly on outstanding guaranteed loans. For loans made prior to October 1, 1980, the allowance is determined from the average yield of 91-day U.S. Treasury bills auctioned during the quarter, less 3.5% on 7% loans, 5.5% on 9% loans, and 4.5% on 8% loans. The allowance for loans made on or after October 1, 1980 is one-half the previous amount, but not less than 2.5% for 7% loans, 0.5% for 9% loans, and 1.5% for 8% loans.

**4. CASH AND CASH EQUIVALENTS, DESIGNATED CASH EQUIVALENTS, AND INVESTMENTS**

**Deposits**—As of June 30, 2003 and 2002, the carrying amounts of LCF’s deposits were \$244,148 and \$807,989, respectively, and the bank balances were \$304,325 and \$307,509, respectively. All of the bank balances at June 30, 2003 are classified as GASB No. 3 Credit Risk Category 1, which includes securities that are insured, registered, or held by MHESO’s trustee in MHESO’s name.

**Investments**—Investments of the LCF are made in accordance with the bond resolutions and various Minnesota Statutes. All investments as of June 30, 2003 and 2002 are classified as GASB No. 3 Credit Risk Category 1, as defined above.

Cash and cash equivalents, designated cash equivalents, and investments consist of the following as of June 30, 2003:

	<b>Market</b>	<b>Cost</b>
Cash, interest-bearing	\$ 93,767,709	\$ 93,767,709
Commercial paper	8,002,624	7,993,375
Municipal funds	39,756,209	39,756,209
Funds in state treasurer’s investment pool	<u>4,417,656</u>	<u>4,417,656</u>
	<u>\$ 145,944,198</u>	<u>\$ 145,934,949</u>

Cash and cash equivalents, designated cash equivalents, and investments consist of the following as of June 30, 2002:

	<b>Market</b>	<b>Cost</b>
Cash, interest-bearing	\$ 36,198,476	\$ 36,198,476
U.S. Government and agency obligations	12,604,664	12,528,479
Commercial paper	82,567,902	82,277,510
Municipal funds	18,610,174	18,610,174
Funds in state treasurer’s investment pool	<u>4,030,617</u>	<u>4,030,617</u>
	<u>\$ 154,011,833</u>	<u>\$ 153,645,256</u>

## 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003 was as follows:

	<b>Primary Government</b>		
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Ending Balance</b>
Governmental activities:			
Equipment	\$ 230,038		\$ 230,038
Less accumulated depreciation for equipment	<u>(135,171)</u>	<u>\$ (30,311)</u>	<u>(165,482)</u>
Government activities capital assets, net	94,867	(30,311)	64,556
Business-type activities:			
Equipment	91,584		91,584
Less accumulated depreciation for equipment	<u>(77,409)</u>	<u>(5,756)</u>	<u>(83,165)</u>
Business-type activities capital assets, net	<u>14,175</u>	<u>(5,756)</u>	<u>8,419</u>
Total capital assets, net	<u>\$ 109,042</u>	<u>\$ (36,067)</u>	<u>\$ 72,975</u>

Capital asset activity for the year ended June 30, 2002 was as follows:

	<b>Primary Government</b>		
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Ending Balance</b>
Governmental activities:			
Equipment	\$ 191,071	\$ 38,967	\$ 230,038
Less accumulated depreciation for equipment	<u>(105,991)</u>	<u>(29,180)</u>	<u>(135,171)</u>
Government activities capital assets, net	85,080	9,787	94,867
Business-type activities:			
Equipment	91,584		91,584
Less accumulated depreciation for equipment	<u>(71,581)</u>	<u>(5,828)</u>	<u>(77,409)</u>
Business-type activities capital assets, net	<u>20,003</u>	<u>(5,828)</u>	<u>14,175</u>
Total capital assets, net	<u>\$ 105,083</u>	<u>\$ 3,959</u>	<u>\$ 109,042</u>

## 6. SUPPLEMENTAL STUDENT LOAN PROGRAM REVENUE BONDS

The revenue bonds payable activity within the LCF for the year ended June 30, 2003 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992A, 1992B, and 1992C, due July 2022	\$ 30,000,000			\$ 30,000,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1993, due December 2020	20,000,000			20,000,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1994B, due November 2024	18,500,000			18,500,000
Supplemental Student Loan Program Variable Rate Revenue Bonds (taxable), Series 1999A, due November 2034	61,200,000			61,200,000
Supplemental Student Loan Program Variable Rate Revenue Bonds (taxable), Series 2002A, due January 2037	68,200,000			68,200,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 2002B, due January 2037	27,100,000			27,100,000
Supplemental Student Loan Program Variable Rate Revenue Bonds (taxable), Series 2003B due May 2038		\$ 64,700,000		64,700,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 2003B due May 2038		10,300,000		10,300,000
	225,000,000	75,000,000		300,000,000
Deferred bond issuance costs	(1,571,744)	(569,529)	\$ 54,308	(2,086,965)
	<u>\$ 223,428,256</u>	<u>\$ 74,430,471</u>	<u>\$ 54,308</u>	<u>\$ 297,913,035</u>

The revenue bonds payable activity within the LCF for the year ended June 30, 2002 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992A, 1992B, and 1992C, due July 2022	\$ 30,000,000			\$ 30,000,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1993, due December 2020	20,000,000			20,000,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1994B, due November 2024	18,500,000			18,500,000
Supplemental Student Loan Program Variable Rate Revenue Bonds (taxable), Series 1999A, due November 2034	61,200,000			61,200,000
Supplemental Student Loan Program Variable Rate Revenue Bonds (taxable), Series 2002A, due January 2037		\$ 68,200,000		68,200,000
Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 2002B, due January 2037		27,100,000		27,100,000
	129,700,000	95,300,000		225,000,000
Deferred bond issuance costs	(887,628)	(726,684)	\$ 42,568	(1,571,744)
	<u>\$ 128,812,372</u>	<u>\$ 94,573,316</u>	<u>\$ 42,568</u>	<u>\$ 223,428,256</u>

The Series 1992A, 1992B, 1992C, and 1993 bonds are special, limited obligations of MHESO. The issued bonds of the LCF do not constitute debt of the State of Minnesota.

Annual debt service requirements to maturity for revenue bonds are as follows:

	<b>Business-Type Activities</b>		
	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
Year Ending June 30:			
2004		\$ 3,530,850	\$ 3,530,850
2005		3,530,850	3,530,850
2006		3,530,850	3,530,850
2007	\$ 714,286	3,530,850	4,245,136
2008	3,428,571	3,523,350	6,951,921
2009-2013	21,459,525	17,018,475	38,478,000
2014-2018	23,309,523	15,820,625	39,130,148
2019-2023	40,411,429	14,350,251	54,761,680
2024-2028	79,016,666	10,898,873	89,915,539
2029-2033	77,166,668	6,186,973	83,353,641
2034-2038	<u>54,493,332</u>	<u>1,777,597</u>	<u>56,270,929</u>
	<u>\$ 300,000,000</u>	<u>\$ 83,699,544</u>	<u>\$ 383,699,544</u>

Interest rates on the tax-exempt 1992, 1993, and 1994B series of bonds vary weekly based on the determination by the remarketing agent of the lowest rate that would permit the sale of bonds at par plus accrued interest on the date of determination. The variable rate cannot exceed 15% per annum. The interest rate for the Series 1992, 1993, and 1994B bonds as of June 30, 2003 and 2002 was 1.05% and 1.35%, respectively.

The interest rate on the taxable Series 1999A bonds, taxable Series 2002A bonds, tax-exempt Series 2002B bonds, taxable Series 2003A bonds, and tax-exempt Series 2003B bonds reset every 28, 28, 35, 28, and 35 days, respectively, based on a determination by the auction agent through auction proceedings. The rate cannot exceed the lesser of the applicable LIBOR rate plus 1% or 17%. The interest rate as of June 30, 2003 and 2002 for the Series 1999A bonds was 1.13% and 1.95%, respectively. The interest rate as of June 30, 2003 and 2002 for the Series 2002A and 2002B bonds was 1.28% and 2.02% and 1.08% and 1.43%, respectively. The interest rate as of June 30, 2003 for the Series 2003A and 2003B bonds was 1.30% and 1.10%, respectively.

MHESO maintains aggregate liquidity facilities with the banks in connection with the outstanding 1992 (A, B, and C), 1993, and 1994B tax-exempt bond issues. The total credit facility available under these facilities was \$69,457,123 at June 30, 2003 and 2002. The fees to maintain these facilities are calculated as 0.30% of the outstanding principal amount of the Series 1992 (A, B, and C) and 1993 bonds and 0.35% of the principal amount of the 1994B bonds. General and administrative expenses include liquidity fees of \$215,415 and \$219,264 for the years ended June 30, 2003 and 2002, respectively.

For the Series 1999A, 2002A taxable bonds, 2002B tax-exempt bonds, 2003A taxable bonds, and 2003 tax-exempt bonds, MHESO maintains liquidity insurance coverage in the amount of \$4,630,000. The fees to maintain this coverage are calculated as 0.12% for Series 1999A, 2002A, and 2002B and 0.14% for Series 2003A and 2003B of the outstanding principal amount per year.



General and administrative expenses include liquidity insurance fees of \$228,342 and \$161,440 for the years ended June 30, 2003 and 2002, respectively.

All bond series are to be repaid solely from the money and investments held by the trustees. All the bond series are secured by the revenues derived by MHESO from the student loans financed by the proceeds of the bonds. For all bonds, an early repayment provision exists. For the tax-exempt bonds, MHESO must give written notice to exercise its option to redeem bonds at least 45 days prior to the desired redemption date. The paying agent would notify MHESO in writing of bonds selected for redemption and the principal amount to be redeemed. MHESO would then be required to make satisfactory provision for deposit in the Redemption Fund for the principal and interest accrued. For the taxable bond issue, MHESO must give written notice to the bond trustee and credit provider not less than 20 days but no greater than 65 days prior to redemption.

**Arbitrage Regulations**—The \$105.9 million of tax-exempt bonds issued by MHESO are subject to the 1986 Tax Reform Act regulations relating to arbitrage reporting and rebate. Any earnings in excess of the bond yield must be remitted to the U.S. Government not more than five years following the issue date of the bonds. As of June 30, 2003, amounts rebatable relating to such excess earnings were not significant as determined by Springsted, MHESO's bond advisors.

## **7. PENSION PLAN**

Employees of MHESO meeting certain age and length of service requirements participate in the State Employees' Retirement Fund ("SERF") of the Minnesota State Retirement System ("MSRS"). The SERF requires contributions by both employers and employees. MHESO's contribution to the SERF for the year ended June 30, 2003 and 2002 was \$142,139 and \$138,688, respectively. The total covered payroll of MHESO for the years ended June 30, 2003 and 2002 was \$3,486,941 and \$3,448,899, respectively.

The SERF is a statewide plan that covers employees of the State of Minnesota, school districts, counties, cities, and other political subdivisions. The SERF is a multiple-employer, cost-sharing defined benefit plan administered by MSRS. Benefits are based on average salary and are fully vested after three years of credited service. Participants are required to contribute 4.0% of their total compensation with a matching MHESO contribution of 4.0%. The contribution rates for the SERF are not actuarially determined, but rather are determined by the state statute.

The pension benefit obligation is a standardized measure of the actuarial present value of credited projected benefits. The measure is intended to help users assess the SERF's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems.

The unfunded vested benefit liabilities of the SERF are not actuarially segregated by employer unit. As of June 30, 2002 (the most recent information available), MHESO's contributions and employees represented less than 1% of all participating entity contributions and active plan participants in SERF.

The SERF issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing or calling the plan at:

Minnesota State Retirement System  
Affinity Plus Building, Suite 300  
175 West Lafayette Frontage Road  
Saint Paul, Minnesota 55107-1425  
(651) 296-2761

As of June 30, 2002, the SERF had a projected benefit obligation of \$7,340,397, assets in excess of pension benefit obligation of \$332,631,000, and net assets available for benefits, at fair value, of \$7,673,028,000. As of June 30, 2001, the SERF had a projected benefit obligation of \$6,573,193,000, assets in excess of pension benefit obligation of \$793,480,000, and net assets available for benefits, at fair value, of \$7,366,673,000. Ten-year historical trend information showing the SERF's progress in accumulating sufficient assets to pay benefits when due is presented in the SERF's June 30, 2002 comprehensive annual financial report.

## **8. CONTINGENCIES**

**General Litigation**—MHESO is involved in litigation arising in the normal course of business. It is management's opinion that these matters will be resolved without material adverse effect on MHESO's financial statements.

## **9. TRANSFER TO STATE OF MINNESOTA GENERAL FUND**

During June of 2003, due to legislative actions, \$30 million from the Loan Capital Fund was transferred to the State of Minnesota General Fund.

\* \* \* \* \*

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**SUPPLEMENTAL SCHEDULES FOR THE YEARS ENDED  
JUNE 30, 2003 AND 2002**

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## STATEMENT OF NET ASSETS AND CHANGES IN NET ASSETS OF AGENCY FUNDS JUNE 30, 2003

---

ASSETS -	
Receivables	\$ 374,699
LIABILITIES -	
Accounts payable	<u>374,699</u>
UNRESTRICTED NET ASSETS	<u>\$ -</u>
UNRESTRICTED NET ASSETS AT JUNE 30, 2002	\$ -
Agency funds received	3,599,437
Agency funds disbursed	<u>3,599,437</u>
UNRESTRICTED NET ASSETS AT JUNE 30, 2003	<u>\$ -</u>

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## STATEMENT OF NET ASSETS AND CHANGES IN NET ASSETS OF AGENCY FUNDS JUNE 30, 2002

---

### ASSETS:

Cash	\$ 153,305
Receivables	645,199

### LIABILITIES -

Accounts payable	<u>798,504</u>
------------------	----------------

### UNRESTRICTED NET ASSETS

\$ -

### UNRESTRICTED NET ASSETS AT JUNE 30, 2001

\$ -

Agency funds received	3,516,588
Agency funds disbursed	<u>3,516,588</u>

### UNRESTRICTED NET ASSETS AT JUNE 30, 2002

\$ -

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## BUDGETARY COMPARISON SCHEDULE YEAR ENDED JUNE 30, 2003

	<u>Budgeted Amounts</u>		<b>Actual Amounts (Budgetary Basis)</b>	<b>Variance with Final Budget Positive (Negative)</b>
	<b>Original</b>	<b>Final</b>		
Resources (inflows):				
Governmental:				
State appropriations	\$ 147,850,000	\$ 146,919,000	\$ 145,778,000	\$ (1,141,000)
State grants	46,000	68,335	68,335	
Federal grants	4,306,583	6,434,162	4,402,523	(2,031,639)
Student loan repayments	73,000	73,000	50,178	(22,822)
Interest on student loans	17,000	17,000	21,287	4,287
Private postsecondary registration	40,800	40,800	32,500	(8,300)
Professional career schools registration	71,800	71,800	107,808	36,008
All other reimbursements	<u>67,400</u>	<u>67,400</u>	<u>167,886</u>	<u>100,486</u>
Total governmental resources	152,472,583	153,691,497	150,628,517	(3,062,980)
Business-type activities:				
Student loan repayments	9,600,000	9,600,000	9,126,196	(473,804)
Interest on short-term investments	636,000	636,000	640,442	4,442
All other reimbursements	<u>129,750,000</u>	<u>129,750,000</u>	<u>203,914,305</u>	<u>74,164,305</u>
Total business-type resources	<u>139,986,000</u>	<u>139,986,000</u>	<u>213,680,943</u>	<u>73,694,943</u>
Total resources	<u>\$ 292,458,583</u>	<u>\$ 293,677,497</u>	<u>\$ 364,309,460</u>	<u>\$ 70,631,963</u>
Expenditures (outflows):				
Governmental:				
Salaries and benefits	\$ 3,780,083	\$ 3,527,730	\$ 3,283,990	\$ 243,740
Space rental, maintenance, and utility	308,000	317,004	304,252	12,752
Repairs, alterations, and maintenance	43,000	23,148	19,277	3,871
Printing and advertising	201,000	144,261	90,692	53,569
Professional and technical outside vendors	193,000	334,491	321,709	12,782
Computer and systems services	773,000	995,722	990,722	5,000
Communications	111,000	103,041	87,843	15,198
Travel and subsistence - in state	129,000	126,005	108,783	17,222
Travel and subsistence - out state	48,000	8,000	4,126	3,874
Supplies	108,000	152,617	101,498	51,119
Equipment	78,000	84,451	78,075	6,376
Employee development	130,000	100,327	32,942	67,385
Other operating costs	5,329,000	292,759	(129,593)	422,352
Agency indirect costs	29,000	141,000	139,025	1,975
Statewide indirect costs	46,000	50,712	50,712	
Attorney general costs	9,000	5,446	5,446	
State agency reimbursement		(80,970)	(69,885)	(11,085)
Professional and technical agency provided		229,833	559,030	(329,197)
Medical/rehabilitation	2,000	2,000	1,500	500
Other payments to individuals	134,268,911	135,489,382	135,746,733	(257,351)
Aid to higher education institutions	5,525,953	8,892,486	11,178,633	(2,286,147)
Aid to nongovernmental organizations	5,123,000	5,294,325	1,263,653	4,030,672
Distributions of amounts collected	<u>90,000</u>	<u>90,000</u>	<u>71,465</u>	<u>18,535</u>
Total governmental expenditures	156,324,947	156,323,770	154,240,628	2,083,142

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## BUDGETARY COMPARISON SCHEDULE YEAR ENDED JUNE 30, 2003 (CONTINUED)

	<u>Budgeted Amounts</u>		<b>Actual Amounts (Budgetary Basis)</b>	<b>Variance with Final Budget Positive (Negative)</b>
	<b>Original</b>	<b>Final</b>		
Expenditures (outflows): cont.				
Business-type activities:				
Salaries and benefits	\$ 1,350,000	\$ 1,162,406	\$ 1,161,956	\$ 450
Space rental, maintenance, and utility	181,000	167,981	167,981	
Repairs, alterations, and maintenance	11,000	4,230	4,230	
Printing and advertising	59,000	57,006	38,460	18,546
Professional and technical outside vendors	366,000	303,407	184,525	118,882
Computer and systems services	26,000	21,551	20,966	585
Communications	64,000	50,245	52,007	(1,762)
Travel and subsistence - in state	20,000	6,903	6,962	(59)
Travel and subsistence - out state	21,000			
Supplies	36,000	29,860	27,721	2,139
Equipment	32,000	22,967	22,967	
Employee development	20,000	5,353	5,353	
Other operating costs	10,130,000	11,122,132	10,779,192	342,940
Statewide indirect costs	80,000	45,957	45,957	
Attorney general costs		5,966	7,111	(1,145)
Professional and technical agency provided		2,334	2,334	
Loans and advances	115,300,000	107,480,902	107,480,902	
Debt service				
Total business-type activities expenditures	<u>127,696,000</u>	<u>120,489,200</u>	<u>120,008,624</u>	<u>480,576</u>
Total expenditures	<u>\$ 284,020,947</u>	<u>\$ 276,812,970</u>	<u>\$ 274,249,252</u>	<u>\$ 2,563,718</u>

# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## BUDGETARY COMPARISON SCHEDULE YEAR ENDED JUNE 30, 2002

	<u>Budgeted Amounts</u>		<b>Actual Amounts (Budgetary Basis)</b>	<b>Variance with Final Budget Positive (Negative)</b>
	<u>Original</u>	<u>Final</u>		
Resources (inflows):				
Governmental:				
State appropriations	\$ 148,699,000	\$ 145,955,000	\$ 160,755,000	\$ 14,800,000
State grants	40,000	88,500	71,911	(16,589)
Federal grants	3,629,215	4,888,715	3,750,311	(1,138,404)
Student loan repayments	41,000	81,000	74,112	(6,888)
Interest on student loans	19,000	19,000	19,467	467
Private postsecondary registration	38,900	38,900	28,700	(10,200)
Professional career schools registration	71,900	71,900	116,930	45,030
All other reimbursements	74,200	576,700	266,479	(310,221)
Total governmental resources	152,613,215	151,719,715	165,082,910	13,363,195
Business-type activities:				
Student loan repayments	12,293,000	12,293,000	8,678,914	(3,614,086)
Interest on short-term investments	875,000	875,000	548,077	(326,923)
All other reimbursements	115,330,000	130,330,000	117,648,933	(12,681,067)
Total business-type resources	128,498,000	143,498,000	126,875,924	(16,622,076)
Total resources	<u>\$ 281,111,215</u>	<u>\$ 295,217,715</u>	<u>\$ 291,958,834</u>	<u>\$ (3,258,881)</u>
Expenditures (outflows):				
Governmental:				
Salaries and benefits	\$ 3,484,313	\$ 3,515,438	\$ 3,318,130	\$ 197,308
Space rental, maintenance, and utility	316,000	303,474	304,685	(1,211)
Repairs, alterations, and maintenance	49,000	33,258	31,019	2,239
Printing and advertising	226,000	198,053	161,904	36,149
Professional and technical outside vendors	330,000	2,179,278	2,187,889	(8,611)
Computer and systems services	80,000	274,375	243,226	31,149
Communications	122,000	103,398	111,673	(8,275)
Travel and subsistence - in state	131,000	121,496	123,247	(1,751)
Travel and subsistence - out state	47,000	10,928	12,317	(1,389)
Supplies	115,000	172,641	114,775	57,866
Equipment	91,000	42,696	15,053	27,643
Employee development	131,000	106,389	90,540	15,849
Other operating costs	6,071,500	5,622,631	324,153	5,298,478
Agency indirect costs	28,000	78,000	39,289	38,711
Statewide indirect costs	31,000	40,172	44,421	(4,249)
Attorney general costs	5,000	7,302	7,301	1
State agency reimbursement		(38,592)	(13,650)	(24,942)
Professional and technical agency provided	1,087,298	1,237,818	1,297,798	(59,980)
Medical/rehabilitation	1,000	1,000	1,452	(452)
Other payments to individuals	133,653,039	146,945,596	146,155,631	789,965
Aid to higher education institutions	7,373,356	6,550,174	10,839,190	(4,289,016)
Inter-agency grants			483,176	(483,176)
Aid to nongovernmental organizations	48,000	1,352,468	1,309,679	42,789
Distributions of amounts collected		95,000	93,579	1,421
Total governmental expenditures	153,420,506	168,952,993	167,296,477	1,656,516



# MINNESOTA HIGHER EDUCATION SERVICES OFFICE

## BUDGETARY COMPARISON SCHEDULE YEAR ENDED JUNE 30, 2002 (CONTINUED)

	<u>Budgeted Amounts</u>		<b>Actual Amounts (Budgetary Basis)</b>	<b>Variance with Final Budget Positive (Negative)</b>
	<u>Original</u>	<u>Final</u>		
Expenditures (outflows): cont.				
Business-type activities:				
Salaries and benefits	\$ 1,282,000	\$ 1,282,000	\$ 1,066,992	\$ 215,008
Space rental, maintenance, and utility	158,000	158,000	157,709	291
Repairs, alterations, and maintenance	11,000	11,000	11,117	(117)
Printing and advertising	59,000	59,000	56,815	2,185
Professional and technical outside vendors	4,896,000	896,000	401,176	494,824
Computer and systems services	26,000	26,000	15,312	10,688
Communications	64,000	64,000	56,166	7,834
Travel and subsistence - in state	20,000	20,000	9,042	10,958
Travel and subsistence - out state	21,000	21,000	3,874	17,126
Supplies	36,000	36,000	24,990	11,010
Equipment	40,000	40,000	8,464	31,536
Employee development	20,000	20,000	11,931	8,069
Other operating costs	5,165,000	11,265,000	8,736,862	2,528,138
Statewide indirect costs	80,000	80,000	48,874	31,126
Attorney general costs			13,544	(13,544)
Professional and technical agency provided			9,233	(9,233)
Loans and advances	105,500,000	105,500,000	104,156,163	1,343,837
Debt service	<u>10,200,000</u>	<u>10,200,000</u>		<u>10,200,000</u>
Total business-type activities expenditures	<u>127,578,000</u>	<u>129,678,000</u>	<u>114,788,264</u>	<u>14,889,736</u>
Total expenditures	<u>\$ 280,998,506</u>	<u>\$ 298,630,993</u>	<u>\$ 282,084,741</u>	<u>\$ 16,546,252</u>

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**APPENDIX II**

**DEFINITIONS OF CERTAIN TERMS AND  
SUMMARY OF THE INDENTURE**

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## DEFINITIONS OF CERTAIN TERMS AND SUMMARY OF THE INDENTURE

The following are brief descriptions of certain provisions of the General Indenture, Sixth Supplemental Indenture and the Seventh Supplemental Indenture and the definitions of certain terms used therein and herein. Such descriptions do not purport to be comprehensive or definitive. All references herein to the General Indenture, the Sixth Supplemental Indenture or the Seventh Supplemental Indenture are qualified in their entirety by reference to the definitive forms of such documents, copies of which are available for review, at the offices of Purchasing Agent, and, after issuance, at the office of the Trustee.

### CERTAIN DEFINITIONS

“AA' Composite Commercial Paper Rate”, on any date of determination, shall mean (i) the interest equivalent of the 30-day rate on commercial paper placed on behalf of issuers whose corporate bonds are rated “AA” by S&P or the equivalent of such rating by a nationally recognized rating agency, as such 30-day rate is made available on a discount basis or otherwise by the Federal Reserve Bank of New York for the Business Day immediately preceding such date of determination; or (ii) if the Federal Reserve Bank of New York does not make available any such rate, then the arithmetic average of the interest equivalent of the 30-day rate on commercial paper placed on behalf of such issuers, as quoted to the Auction Agent on a discount basis or otherwise, by at least three dealers of commercial paper, or such fewer entities as may then be dealers of commercial paper, as of the close of business on the Business Day immediately preceding such date of determination. For purposes of this definition, the “interest equivalent” of a rate stated on a discount basis (a “discount rate”) for commercial paper of a given day’s maturity shall be equal to the product of (A) 100 times (B) the quotient (rounded upwards to the next higher one-thousandth (.001) of 1 %) of (x) the discount rate (expressed in decimals) divided by (Y) the difference between (1) 1.00 and (2) a fraction the numerator of which shall be the product of the discount rate (expressed in decimals) times the number of days in which such commercial paper matures and the denominator of which shall be 360.

“Accountant” means any independent certified public accountant as may be selected by MHESO.

“Act” means Minnesota Statutes, Sections 136A.15 through 136A.178, as amended.

“Adjustable Rate Bonds” means those Bonds whose terms provide for the adjustment of the interest rate to be borne by such Bonds periodically prior to their stated maturity and may, under the terms of a Supplemental Indenture, provide for mandatory tender or tender optionally upon demand of the Owner thereof.

“Advisory Council” means the Minnesota Higher Education Advisory Council.

“After-Tax Equivalent Rate” means, on any Auction Date, the interest rate per annum equal to the product of (i) the AA Composite Commercial Paper Rate on such date and (ii) 1.00 minus the lower of the Statutory Corporate Tax Rate and the Statutory Personal Tax Rate on such date. For purposes of this definition, the term “Statutory Corporate Tax Rate” means, as of any date of determination, the highest tax rate bracket (expressed in decimals) now or hereafter applicable in each taxable year on the taxable income of every corporation as set forth in Section 11 of the Code or any successor section without regard to any minimum additional tax provision or provisions regarding changes in rates during the taxable year, which on the date hereof is .35; and “Statutory Personal Tax Rate” means, as of any date of determination, the highest tax rate bracket (expressed in decimals) now or hereafter applicable in each taxable year on the taxable income of a natural person as set forth in Section 1 of the Code or any successor section without regard to any minimum additional tax provision or provisions regarding changes in rates during a taxable year, which on the date hereof is .35.

“All-Hold Rate” on any date of determination, shall mean, with respect to the 2004 Series A Bonds, the interest rate per annum equal to 90% of the Applicable LIBOR Rate, rounded to the nearest one thousandth of 1% (.001); provided that in no event shall the All-Hold Rate be more than the Interest Rate Limitation or less than zero and, with respect to the 2004 Series B Bonds, the interest rate per annum equal to 90% (as such percentage may be adjusted pursuant to Section 3.9 hereof) of the lesser of (a) the After-Tax Equivalent Rate on such date or (b) the Kenny Index on such date, rounded down to the nearest one thousandth (.001) of 1%; provided, however, that in no event shall such All-Hold Rate be more than the Interest Rate Limitation or less than zero.

“Alternate Liquidity Facility” means any letter of credit, line of credit, standby bond purchase agreement, surety bond or other financial instrument utilized to provide liquidity support pursuant to Article VI of the Seventh Supplemental Indenture, which will not result in a reduction or withdrawal of any ratings then in effect on any Bonds bearing interest at Adjustable Rates (other than Auction Rates), and issued by the Liquidity Provider prior to the stated termination of the Liquidity Facility then in effect.

“Applicable LIBOR Rate” means (i) for Auction Periods of 28 days or less, One-Month LIBOR, (u) for Auction Periods of more than 28 days but less than 91 days, Three-Month LIBOR, (iii) for Auction Periods of more than 90 days but less than 181 days, Six-Month LIBOR, and (iv) for Auction Periods of more than 180 days, One-Year LIBOR. As used in this definition and otherwise herein, the terms “*One-Month LIBOR*,” “*Three-Month LIBOR*,” “*Six-Month LIBOR*” or “*One-Year LIBOR*” mean the rate of interest per annum equal to the rate per annum at which United States dollar deposits having a maturity of one-month, three months, six months or one year, respectively, are offered to prime banks in the London interbank market which appear on the Reuters Screen LIBOR Page as of approximately 11:00 a.m., London time, on the Determination Date. If at least two such quotations appear, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, will be the arithmetic mean (rounded upwards, if necessary, to the nearest one-hundredth of one percent) of such offered rates. If fewer than two such quotes appear, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, with respect to such Interest Period will be determined at approximately 11:00 a.m., London time, on such Determination Date on the basis of the rate at which deposits in United States dollars having a maturity of one month, three months, six months or one year, respectively, are offered to prime banks in the London interbank market by four major banks in the London interbank market selected by the Auction Agent or the Trustee, as applicable, and in a principal amount of not less than U.S. \$1,000,000 and that is representative for a single transaction principal London office of each of such banks to provide a quotation of its rate. If at least two quotations are provided, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, will be the arithmetic mean (rounded upwards, if necessary, to the nearest one-hundredth of one percent) of such offered rates. If fewer than two quotations are provided, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, with respect to such Interest Period will be the arithmetic mean (rounded upwards, if necessary, to the nearest one-hundredth of one percent) of the rates quoted at approximately 11:00 a.m., New York City time on such Determination Date by three major banks in New York, New York selected by the Auction Agent or the Trustee, as applicable, for loans in United States dollars to leading European banks having a maturity of one month, three months, six months or one year, respectively, and in a principal amount equal to an amount of not less than U.S. \$1,000,000 and that is representative for a single transaction in such market at such time; provided, however, that if the banks selected as aforesaid are not quoting as mentioned in this sentence, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, in effect for the applicable Interest Period will be One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, in effect for the immediately preceding Interest Period.

“Applicable Percentage” on any date of determination, means the percentage determined based on the rating of the 2004 Series B Bonds in effect at the close of business on the Business Day immediately preceding such date, or, if the 2004 Series B Bonds are then rated by more than one Rating Agency, based on the lower of such ratings on such Business Day, as set forth below:

#### **CREDIT RATING**

<u>Standard &amp; Poor's</u>	<u>Moody's Investors Service</u>	<u>Fitch Ratings</u>	<u>Applicable Percentage</u>
“AAA”	“Aaa”	“AAA”	175%
“AA-” to “AA+”	“Aa3” to “Aa1”	“AA-” to “AA+”	175%
“A-” to “A+”	“A3” to “A1”	“A-” to “A+”	175%
“BBB-” to “BBB+”	“Baa3” to “Baal”	“BBB-” to “BBB+”	200%
Below “BBB-”	Below “Baa3”	Below “BBB-”	250%

as such percentages may be: adjusted pursuant to Section 3.9 of the Seventh Supplemental Indenture; provided, that if the 2004 Series B Bonds are not then rated by a Rating Agency, or if a Payment Default shall have occurred and be continuing, the Applicable Percentage shall be 250%, as such percentage may be adjusted pursuant to Section 3.9 of the Seventh Supplemental Indenture. For purposes of this definition, the rating categories listed above refer to and include the respective rating categories correlative thereto if any Rating Agency has changed or modified its generic rating categories or no longer rates the 2004 Series B Bonds or has been replaced.

“Applicable RAMS Rate” means, with respect to any 2004 Series A Bonds while bearing interest determined pursuant to the Auction Procedures, the Auction Rate at the time in effect for such 2004 Series A Bonds.

“Applicable Spread” shall mean, on any date of determination, the following percentages, based on the lowest rating assigned to a Series of Bonds:

#### CREDIT RATING

<u>Standard &amp; Poor’s</u>	<u>Moody’s Investors Service</u>	<u>Fitch Ratings</u>	<u>Applicable Spread</u>
“AAA”	“Aaa”	“AAA”	1.25
“AA-” to “AA+”	“Aa3” to “Aa1”	“AA-” to “AA+”	1.25
“A-” to “A+”	“A3” to “A1”	“A-” to “A+”	1.25
“BBB-” to “BBB+”	“Baa3” to “Baa1”	“BBB-” to “BBB+”	1.50
Below “BBB-”	Below “Baa3”	Below “BBB-”	2.00

“Auction Agency Agreement” shall mean the Auction Agency Agreements, dated as of July 1, 2004, among the Trustee, MHESO and the initial Auction Agent and any similar agreement with a successor Auction Agent, in each case as from time to time amended or supplemented relating to a series of 2004 Series Bonds.

“Auction Agent” means any Person designated as such pursuant to the Sixth Supplemental Indenture or Seventh Supplemental Indenture, respectively.

“Auction Agent Fee” means the fee paid by MHESO to the Auction Agent pursuant to an Auction Agency Agreement.

“Auction Date” shall mean, with respect to the 2004 Series A Bonds, initially the date specified in the Sixth Supplemental Indenture, and, thereafter, the Business Day immediately preceding the first day of each Interest Period, other than

- (a) an Auction Period which commences on a Fixed Rate Conversion Date;
- (b) each Auction Period commencing after the ownership of RAMS is no longer maintained in book-entry form by the Depository;
- (c) each Auction Period commencing after the occurrence and during the continuance of a Payment Default; or
- (d) any Auction Period commencing less than two Business Days after the cure of waiver of a Payment Default.

Notwithstanding the foregoing, the Auction Date for one or more Auction Periods may be changed pursuant to the Sixth Supplemental Indenture.

With respect to the 2004 Series B Bonds, the Auction Date shall mean initially the date specified in the Seventh Supplemental Indenture and thereafter the Business Day immediately preceding the first day of each Auction Period other than (i) an Auction Period which commences on a Conversion Date; (ii) each Auction Period commencing after the ownership of the Bonds is no longer maintained in Book-Entry Form by the Securities Depository; (iii) each Auction Period commencing after the occurrence and during the continuance of a Payment Default; or (iv) each Auction Period commencing less than two Business Days after the cure or waiver of a Payment Default. Notwithstanding the foregoing, the Auction Date for one or more Auction Periods may be changed pursuant to the Seventh Supplemental Indenture.

“Auction Period” shall mean, with respect to the 2004 Series A Bonds, the respective Interest Period applicable as the same may be changed pursuant to the Sixth Supplemental Indenture with a Credit Confirmation and, with respect to the 2004 Series B Bonds, the Interest Period applicable to the 2004 Series B Bonds during which time the Bond Interest Rate is determined pursuant to Section 3.2 of the Seventh Supplemental Indenture, which Auction Period (after the Initial Period) initially shall consist generally of 35 days, as the same may be adjusted pursuant to Section 3.6 of the Seventh Supplemental Indenture with Credit Confirmation.

“Auction Rate” means the rate of interest per annum determined for the 2004 Series A Bonds or 2004 Series B Bonds that bear interest at an Auction Rate pursuant to the implementation of the Auction Procedures, provided, however, such rate of interest shall not exceed the Interest Rate Limitation.

“Authenticating Agent” means the Trustee or any other Indenture Agent as may be authorized pursuant to a Supplemental Indenture to perform the acts required of such agent in conformance with the provisions of the General Indenture and the related Supplemental Indenture.

“Authorized Representative” means the Director of MHESO, or any other person designated by the Director of MHESO to act as the authorized representative of MHESO.

“Available Bonds” means such Bonds which are not subject to Submitted Hold Orders, as provided in Section 3.2(c)(i)(A) of Exhibit A to the Sixth Supplemental Indenture or the Seventh Supplemental Indenture, respectively.

“Beneficial Owner” means, when a Series of Bonds are registered in the Book-Entry System, any person who acquires a beneficial ownership interest in a Bond of that Series held by the Securities Depository.

“Bid” has the meaning set forth in Section 3.2(a)(i) of Exhibit A to the related Supplemental Indenture.

“Bidder” means an Existing Owner or Potential Owner that places an Order.

“Bond” means one of the bonds authenticate and delivered pursuant to the General Indenture, including any additional or refunding Bonds issued pursuant to Article II of the General Indenture.

“Bond Counsel” means the firm of Best & Flanagan LLP of Minneapolis, Minnesota, or any other firm of attorneys designated by MHESO and duly admitted to practice law before the highest court of any state and nationally recognized in the field of municipal finance.

“Bond Equivalent Yield” shall mean, with respect to any security with a maturity of six months or less the rate for which is quoted in *The Wall Street Journal* on a bank discount basis, the yield calculated in accordance with the following formula and rounded up to the nearest one one-hundredth of one percent:

$$\frac{R \times N}{360 - (N \times D)} \times 100$$

where “R” refers to the interest rate per annum for the security quoted on a bank discount basis expressed as a decimal, “N” refers to 365 or 366 days, as applicable, and “D” refers to the number of days to maturity.

“Bondholder,” when used with reference to a Bond, means the Owner of such Bond

“Bond Insurer” means MBIA Insurance Corporation, a Credit Provider pursuant to the terms of the Supplemental Indenture.

“Book-Entry Form” or “Book-Entry System” shall mean a form or system under which (i) the beneficial right to principal and interest may be transferred only through a book entry, (ii) physical securities in registered form are issued only to a Securities Depository or its nominee as registered holder, with the securities “immobilized” to the custody of the Securities Depository, and (iii) the book entry is the record that identifies the owners of beneficial interests in that principal and interest.

“Broker-Dealer” means, initially, RBC Dain Rauscher Inc., and any other broker or dealer (as defined in the Securities Exchange Act), commercial bank or other entity permitted by law to perform the functions required of a Broker-Dealer set forth in the Auction Procedures that is a Participant (or an affiliate of a Participant), has been selected by MHESO with a Credit Confirmation pursuant to the related Supplemental Indenture and has entered into a Broker-Dealer Agreement that remains effective.



“Broker-Dealer Agreement” means each agreement between the Auction Agent and a Broker-Dealer pursuant to which the Broker-Dealer agrees to participate in Auctions as set forth in the Auction Procedures, as from time to time amended or supplemented with a Credit Confirmation. Each Broker-Dealer Agreement shall be substantially in the form of the Broker-Dealer Agreement between Bankers Trust Company, as Auction Agent, and RBC Dain Rauscher Inc., as the sole initial Broker-Dealer.

“Business Day” means, when used with reference to the General Indenture, any day other than a Saturday, Sunday, legal holiday or any other day on which banking institutions in the City of New York, New York, or the city in which the principal corporate trust office of the Trustee is located, are generally authorized or obligated by law or executive order to close or are closed or rendered inoperable due to natural disaster, or on which the New York Stock Exchange or on which the office designated for presentation by each Credit Provider then providing a Credit Facility or by each Liquidity Provider then providing a Liquidity Facility for any of the Bonds is closed. Any payments required to be made on any day which is not a Business Day may be made instead on the next succeeding Business Day, and no interest shall accrue on such payments in the interim (except as may otherwise be provided as to a particular Series or Class of Bonds in the Supplemental Indenture and/or Reimbursement Agreement) and, when used with reference to the Supplemental Indenture, means any day other than a Saturday, Sunday or other day on which the New York Stock Exchange or banks are authorized or obligated by law or executive order to close in New York, New York, or in the city in which is located the principal office of the Auction Agent as provided in the Auction Agency Agreement, or, as notified to the Auction Agent in writing, in any city in which is located the principal corporate trust office of the Trustee or the Credit Provider, if any, at which claims on the Credit Facility will be made.

“By Class in Descending Priority” means any treatment of Bonds or the Owners thereof according to the priority of the Class of such Bonds, regardless of Series, with Class I Bonds being of the highest priority and the order of priority descending as the roman numeral identifying the Class increases. Whenever the General Indenture provides for the consent, permission or direction by Owners on a certain matter “By Class in Descending Priority,” it shall mean that the Owners in the particular percentage of ownership described of the most senior Class of Bonds then Outstanding and affected by the matter under consideration shall effect such consent, permission or direction; provided, however, that matters affecting only one Class of Bonds need be approved only by the Owners of the particular percentage of that Class of Bonds except as otherwise provided herein.

“Calculation Period” means any daily, weekly, monthly, semiannual, annual or other period for which an Adjustable Rate (other than an Auction Rate) is determined while the 2004 Series B Bonds bear interest at such Adjustable Rate, as specified in the Conversion Supplement providing for such Adjustable Rate.

“Capital Appreciation Bonds” means those Bonds which, by their terms, do not bear interest, but accrete interest upon the capital portion thereof until stated maturity or earlier redemption.

“Capitalized Interest Subaccount” means the subaccount that may be created in the Revenue Fund in accordance with Section 5.2 of the General Indenture.

“Carry-over Amount” means, with respect to a Series of Adjustable Rate Bonds, the amount, if any, by which (i) the interest payable on such Series with respect to a given interest period is exceeded by (ii) the interest that otherwise would have been payable with respect to such interest period but for a stated limitation on the interest rate for such interest period. To the extent required by the Sixth Supplemental Indenture, interest will accrue on such Carry-over Amount until paid. Any reference to “principal” or “interest” in the Indenture and in the relaxed Bonds shall not include, within the meanings of such words; any Carry-over Amount or any interest accrued on any Carry-over Amount.

“Cash Flow Condition” means, with respect to a given action to be taken or satisfied under the General Indenture, that MHESO has delivered to the Trustee and any Credit Provider a Cash Flow Projection demonstrating that such action will not materially adversely affect MHESO’s ability to pay Debt Service on the Outstanding Bonds, amounts payable to Liquidity Providers, Carry-over Amounts (including accrued interest thereon) with respect to Outstanding Bonds, Program Expenses or to make the required deposits to the credit of the Rebate Fund and the Excess Interest Fund.

“Cash Flow Projection” shall mean a projection, acceptable to the Credit Provider, if any, as to future revenues and cash flow through the final stated maturity of the Outstanding Bonds based upon existing facts and, to the extent not so based, upon assumptions accepted by each Rating Agency and each Credit Provider.

“Certificate” means (i) a signed document either attesting to or acknowledging the circumstances, representations or other matters therein stated or set forth or setting forth matters to be determined pursuant to the General Indenture and any applicable Reimbursement Agreement, or (ii) the report of an Accountant or Authorized Representative as to audits or other procedures called for by the General Indenture and any applicable Reimbursement Agreement, as the case may be.

“Change in the Interest Rate Mode” means any change in the Calculation Period for the Adjustable Rate borne by the 2004 Series B Bonds pursuant to Article IV of the Seventh Supplemental Indenture.

“Change of Preference Law” means any amendment to the Code or other statute enacted by the Congress of the United States or any temporary, proposed or final regulation promulgated by the United States Treasury after the date the 2004 Series B Bonds are issued which (i) changes or would change any deduction, credit or other allowance allowable in computing liability for any federal tax with respect to, or (ii) imposes or would impose or reduces or would reduce or increases or would increase any federal tax (including, but not limited to, preference or excise taxes) upon, any interest earned by any owner of 2004 Series B Bonds.

“Class” means a level of priority of Bonds, among all Series, and of Credit Facilities and Interest Rate Exchange Agreements, as to security and order of payment of principal and interest from the Trust Estate, which shall be further designated by Roman numeral designations, with I being the highest and descending in priority as the numerals increase.

“Closing Date” means the date of the 2004 Series Bond closing.

“Code” means the Internal Revenue Code of 1986, as amended, and the regulations, rulings and court decisions promulgated thereunder and pertaining thereto. Such regulations shall also include any successor provision to any existing regulations thereafter promulgated by the Internal Revenue Service pursuant to Section 103 and Sections 141 through 150 of the Code applicable to the Bonds.

“Conversion” means with reference to the Sixth Supplemental Indenture, any conversion to a Fixed Rate which has been approved or directed by the Credit Provider and, with reference to the Seventh Supplemental Indenture, any Change in the Interest Rate Mode or any conversion to a Fixed Rate which has been approved or directed by the Credit Provider.

“Converted Bonds” means 2004 Series Bonds converted to a Fixed Rate.

“Costs of Issuance” means all items of expense, directly or indirectly payable or reimbursable by or to MHESO and related to the authorization, sale and issuance of Bonds, including, but not limited to, printing costs, costs of preparation and reproduction of documents, filing and recording fees, any bond insurance premiums, fees and expenses of any Credit Provider or Liquidity Provider and its counsel, underwriting fees, initial fees and charges of any Indenture Agent, legal fees, including bond counsel fees and expenses and underwriter’s counsel fees and charges (if charged to MHESO), fees and disbursements of consultants and professionals, Issuer staff travel and expenses related to an issue of Bonds, cost of credit ratings, fees and charges for preparation, execution, transportation and safekeeping of Bonds and any other cost, charge or fee in connection with the original issuance of Bonds.

“Credit Confirmation” means a letter from each Credit Provider then providing a Credit Facility for the Bonds, confirming that the action proposed by MHESO is approved by the Credit Provider.

“Credit Facility” means any form of credit enhancement purchased by MHESO for a Series of Bonds or for one or more Classes within a Series, including, without limitation, a letter of credit, bond insurance, a surety bond or a standby bond purchase agreement, which shall be identified in the Supplemental Indenture for such Series, and may include as part of the same facility, a liquidity component which, if issued separately, would constitute a Liquidity Facility.

“Credit Provider” means the issuer of a Credit Facility.

“Debt Service” means, with respect to any particular Fiscal Year and any particular Series of Bonds, an amount equal to the sum of (i) all interest payable on such Bonds during such Fiscal Year, plus (ii) any Principal Installments of such Bonds during such Fiscal Year, plus (iii) any additional applicable premium payable on such Bonds during such Fiscal Year, but shall not include the Purchase Price of Bonds or any Carry-over Amounts or interest thereon.

“Debt Service Reserve Fund” means the fund created by that name under Section 5.2 of the General Indenture.

“Debt Service Reserve Requirement” means, as of any date of calculation, an amount equal to the aggregate of the amounts specified in each and every Supplemental Indenture authorizing the issuance of a Series of Bonds as the amount required to be deposited in the Debt Service Reserve Fund with respect to such Series of Bonds and approved by the Credit Provider; if any, with respect to such Series of Bonds; and with respect to each Series of the 2004 Series Bonds; means an amount equal to the greater of (a) two percent of the principal amount of the 2004 Series Bonds Outstanding from time to time or (b) that amount which is in the same proportion to \$250,000 as the principal amount of all such Series of Bonds Outstanding is to the principal amount of Bonds Outstanding.

“Default Claim” means a default claim filed by the Servicer with MHESO under the Servicing Agreement.

“Defaulted Student Loan” means, as of any date of determination, a Student Loan with respect to which either (a) a Default Claim has been filed or (b) any installment of principal or interest was not paid when due (as determined under the related Student Loan without regard to any waiver or forbearance granted by MHESO or the Servicer) and has remained unpaid for a period of at least 165 days.

“Dissemination Agent” means the Trustee, who is responsible for disclosing the information described in the Disclosure Agreement.

“Disclosure Agreement” means the Continuing Disclosure Agreement between MHESO and the Trustee.

“DTC” means The Depository Trust Company, a New York corporation, its successors and assigns.

“Eligible Carry-over Make-Up Amount” means, with respect to each Interest Period relating to the 2004 Series A Bonds as to which, as of the first day of such Interest Period, there is any unpaid Carry-over Amount, an amount equal to the lesser of (a) interest computed on the principal balance of the 2004 Series A Bonds in respect to such Interest Period at a per annum rate equal to the excess, if any, of the Maximum Auction Rate over the Auction Rate, together with the unreduced portion of any such excess from prior Interest Periods and (b) the aggregate Carry-over Amount remaining unpaid as of the first day of such Interest Period together with interest accrued and unpaid thereon through the end of such Interest Period.

“Eligible Funds” shall mean (a) proceeds of the Bonds and the proceeds from the investment thereof; (b) moneys with respect to which the Trustee receives a written opinion of nationally-recognized counsel experienced in bankruptcy matters to the effect that payment of such moneys to the Owners of the Bonds would not constitute a voidable preference under Section 544 or 547 of the Bankruptcy Code and would not be recoverable under Section 550 of the Bankruptcy Code in the event MHESO or an affiliate was to become a debtor under the Bankruptcy Code; or (c) moneys derived from a Credit Facility or Liquidity Facility.

“Eligible Institution” means a post-secondary institution that either (i) is operated or regulated by the State, (ii) if operated publicly or privately in another state, is approved by the U.S. Department of Education or (iii) is chartered in the Canadian Province of Manitoba. All such Eligible Institutions are required to have their chief executive officer sign a SELF Participation Agreement agreeing to perform certain administrative procedures in loan processing and student counseling. With respect to Eligible Institutions described in items (ii) and (iii) above, such schools must maintain academic standards substantially equal to those of comparable institutions operated in Minnesota, as determined by MHESO.

“Event of Default” means any of the events specified in Section 10.1 of the General Indenture.

“Excess Coverage” means, as of any date of calculation, the amount by which the sum of the value of (a) the Student Loans (valued at par plus accrued interest) credited to the Student Loan Fund, other than Defaulted Student Loans, and (b) all cash and Investment Securities held in the Funds and Accounts (valued as set forth in a Supplemental Indenture or in the General Indenture, plus accrued interest, but excluding amounts irrevocably set aside to pay particular Bonds pursuant to Section 12.1 of the General Indenture) shall exceed 103 percent or such lesser percentage with a Credit Confirmation and a Rating Confirmation of the sum of the principal and accrued interest on all Outstanding Class I Bonds as evidenced in a Certificate of an Authorized Representative to the Trustee).

“Excess Interest Fund” means the fund, if any, by that name created in accordance with Section 5.2 of the General Indenture.

“Excess Interest” means, as of the date of computation, the smallest amount that, if treated as a payment for the Student Loans (i.e., taken into account in calculating yield) paid on that date, would reduce the yield on the Student Loans financed by a Series of Bonds which are not Federally Taxable Bonds to a yield that is not higher than the yield on the Bonds plus the Permitted Spread. For purposes of this definition only, yield on the Bonds of any Series and yield on the Student Loans financed by any Series of Bonds shall be calculated in accordance with Treas. Reg. §1.148-4 and 1.148-5, respectively, or such other applicable regulations under the Code.

“Excess Interest Calculation Date” means, with respect to each Series of Bonds which are not Federally Taxable Bonds, a date as of which Excess Interest is calculated, which shall be no later than ten years after the Issue Date for a Series of Bonds and on the same day of each fifth year thereafter while any of the Bonds of the Series is Outstanding, and the day upon which the last Bond of such Series is retired.

“Favorable Opinion” means an Opinion of Bond Counsel to the effect that the action proposed to be taken is authorized or permitted by the General Indenture and any applicable Supplemental Indenture and (except with respect to Federally Taxable Bonds) will not adversely affect the exclusion from gross income for federal income tax purposes of interest on the Bonds which are the subject of such opinion.

“Federally Taxable Bonds” means Bonds so designated by the Supplemental Indenture pursuant to which they are issued, the interest on which is not excludable from gross income for federal income tax purposes.

“Fifth Supplemental Indenture” means (a) the Fifth Supplemental Indenture, dated as of June 1, 2003, by and between MHESO and the Trustee and (b) if the context so indicates, any Indenture supplemental to or amendatory of the General Indenture, executed by MHESO and the Trustee and effective in accordance with Article VIII of the General Indenture.

“Financial Guaranty Insurance Policy” means the insurance policy issued by Bond Insurer insuring payment when due of the principal of and interest (but not any Carry-over Amounts) on a series of 2004 Series Bonds.

“First Supplemental Indenture” means the First Supplemental Indenture, dated as of November 1, 1999, between MHESO and the Trustee.

“Fiscal Year” means a twelve-month period commencing on the 1st day of July of any year, or such other twelve-month period adopted by MHESO as its fiscal year for accounting purposes.

“Fitch” means Fitch Ratings, its successors and assigns, and, if such entity shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, “Fitch” shall be deemed to refer to any other nationally recognized securities rating agency designated by Issuer by an Issuer Order, with written notice thereof to Trustee.

“Fixed Rate” shall mean the rate of interest on any series of 2004 Series Bonds fixed to the maturity thereof and determined pursuant to the related Supplemental Indenture, provided, however, that such rate of interest shall not exceed the related Interest Rate Limitation.

“Fixed Rate Bonds” means those Bonds which, by their terms, bear interest at a specified rate or rates until their stated maturity, payable (except with respect to Capital Appreciation Bonds) semiannually so long as such Bonds are Outstanding, all as may be particularly set forth in a Supplemental Indenture; provided, however, that the first Interest Payment Date for a Series of Fixed Rate Bonds may be for any period up to twelve months from the date of issue thereof.

“Fixed Rate Conversion Date” shall mean the date on which the Fixed Rate takes effect as provided in the Sixth Supplemental Indenture or Seventh Supplemental Indenture, respectively.

“Fixed Rate Period” shall mean the period, if any, during which all or a portion of the 2004 Series A Bonds or the 2004 Series B Bonds bear interest at a Fixed Rate, which period shall commence on the Fixed Rate Conversion Date and extend through the Stated Maturity Date thereof.

“Fourth Supplemental Indenture” means (a) the Fourth Supplemental Indenture, dated as of June 1, 2003, by and between MHESO and the Trustee and (b) if the context so indicates, any Indenture supplemental to or amendatory of the General Indenture, executed by MHESO and the Trustee and effective in accordance with Article VIII of the General Indenture.

“Funds” means any of the funds created and established pursuant to Section 5.2 of the General Indenture; including the Funds and Accounts, the Rebate Fund and the Excess Interest Fund.

“Funds and Accounts” means the Revenue Fund, the Acquisition Fund, the Surplus Fund, the Student Loan Fund; the Credit Proceeds Fund, the Purchase Fund and the Debt Service Reserve Fund created pursuant to Section 5.2 of the General Indenture.

“GAAP” means the generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as may be approved by a significant segment of the accounting profession, which are applicable to the circumstances as of the date of determination.

“General Indenture” means the General Indenture, dated as of November 1, 1999, by and between MHESO and the Trustee.

“Governmental Obligations” means direct obligations of the United States and other obligations, the principal and interest of which are guaranteed by the United States as to full and timely payment.

“Gross Proceeds” when used with respect to a Series of the Bonds that are not Federally Taxable Bonds, means “gross proceeds” of the Series within the meaning of Treas. Reg. 1.148-1(b).

“Hold Order” has the meaning set forth in Section 3.2(a)(i) of Exhibit A to the Sixth Supplemental Indenture or Seventh Supplemental Indenture, respectively.

“Indenture” means the General Indenture and any Supplemental Indentures and any amendments thereto made in accordance with their respective terms.

“Indenture Agent” means the Trustee, the Registrar, the Authenticating Agent, any Depository, any Paying Agent, any Auction Agent, any Remarketing Agent, any Broker-Dealer and any Tender Agent, in each case, approved by the Credit Provider, if any, and any such additional agent as may be authorized pursuant to a Supplemental Indenture and approved by the Credit Provider, if any, or any or all of them as may be appropriate.

“Interest Payment Date” means any date or dates upon which interest on the Bonds is due and payable in accordance with their terms.

“Interest Period” shall mean, with respect to the 2004 Series A Bonds, any Auction Period or the Fixed Rate Period, and with respect to the 2004 Series B Bonds, any Auction Period, the Calculation Period or the Fixed Rate Period.

“Interest Rate Exchange Agreement” means a contract providing for an interest rate cap, floor, swap or other similar instrument entered into pursuant to Section 7.8 of the General Indenture approved by the Credit Provider, if any.

“Interest Rate Limitation” means the lesser of (i) the maximum rate allowable by applicable law or (ii) with respect to the 2004 Series A Bonds, while the 2004 Series A Bonds bear interest at an Auction Rate, 17% or, with respect to the 2004 Series B Bonds, while the 2004 Series B Bonds bear interest at an Auction Rate, 14%.

“Initial Liquidity Facility” means the first of any letter of credit, line of credit, standby purchase agreement, surety bond or other instrument utilized to provide liquidity support in connection with an interest rate change from Auction Rate to a different Adjustable Rate pursuant to the terms of Article IV of the Seventh Supplemental Indenture acceptable to the Credit Provider.

“Investment Rating” means an investment having a rating of (a) “P-1” from Moody’s and “F-1+” from Fitch in the event it has a term of (or is redeemable at the option of the holder within) twelve months or less, (b) at least “A2” and “P-1” from Moody’s and “A” and “F-1+” from Fitch in the event it has a term of (or is redeemable at the option of the holder within) more than 12 months but no more than 24 months, and (c) at least “Aa2” and “P-1” from Moody’s and “AA” and “F-1+” from Fitch in the event it has a term of (or is redeemable at the option of the holder within) more than 24 months.

“Investment Securities,” as defined under the General Indenture, means (to the extent permitted by State law for the investment of funds of MHESO) the following categories of securities, which may be further restricted by the terms of any Reimbursement Agreement or any Supplemental Indenture:

(a) Government Obligations. Such obligations shall be valued (i) in the absence of a dispute or disagreement by utilizing the market values provided to the Trustee’s mainframe trust accounting system by recognized independent financial services (currently Interactive Data System, Inc.) and (ii) in the event of a dispute or disagreement at the average of the bid and asked price as reported the previous Business Day by The Wall Street Journal (but if such information is unavailable, such obligations shall be valued at the bid price as quoted the previous Business Day by at least two dealers in such obligations selected by MHESO);

(b) interest-bearing time or demand deposits, certificates of deposit or other similar banking arrangements with any bank, trust company, national banking association or other depository institution, including the Trustee or any of its affiliates, provided that, at the time of deposit or purchase such depository institution has senior debt rated “Aa2” or higher by Moody’s and, if commercial paper is outstanding, commercial paper which is rated “P-1” by Moody’s and if rated by Fitch “AA” and “F-1.” Such deposits and certificates of deposit shall be valued at par less any withdrawal penalties;

(c) bonds, debentures, notes or other evidences of indebtedness issued or guaranteed by any of the following agencies: Federal Home Loan Mortgage Corporation, the Export-Import Bank of the United States, the Federal National Mortgage Association, the Government National Mortgage Association and the Federal Home Loan Bank; provided that each such obligation is rated “Aaa” by Moody’s; or any agency or instrumentality of the United States of America which shall be established for the purposes of acquiring the obligations of any of the foregoing or otherwise providing financing therefor. Such obligations shall be valued (i) in the absence of a dispute or disagreement by utilizing the market values provided to the Trustee’s mainframe trust accounting system by recognized independent financial services (currently Interactive Data System, Inc.) and (ii) in the event of a dispute or disagreement at the average of the bid and asked price as reported the previous Business Day by The Wall Street Journal (but if such information is unavailable, such obligations shall be valued at the bid price as quoted the previous business day by at least two dealers in such obligation selected by MHESO);

(d) Repurchase agreements with a maturity of no more than 24 months with banks (which may include the Trustee) which are members of the Federal Reserve System and whose senior debt meets the Investment Rating, which such agreements are (i) secured by securities the principal and interest of which are guaranteed by the United States or any of its agencies (without regard to maturity), (ii) are free and clear of any claims by third parties, (iii) are segregated in a custodial or trust account held either by the Trustee or by a third party (other than the repurchaser) approved by MHESO, as the agent solely of, or in trust solely for the benefit of, the Trustee, (iv) are margined at

least 102% valued weekly by the Trustee or the third party custodian, and (v) are “repurchase agreements” as defined in the Bankruptcy Amendments and Federal Judgeship Act of 1984, as amended, and provided that upon the occurrence of an Event of Default under the Indenture, all funds may be withdrawn thereunder, without penalty, by requiring a repurchase. The Trustee will notify the Rating Agencies if any repurchase agreement has a maturity of more than 12 months. Repurchase agreements shall be valued at par;

(e) Repurchase agreements with a maturity of no more than 24 months between the Trustee and another entity whose senior debt meets the Investment Rating, in which one of the parties has agreed to purchase Investment Securities described in items (a) and (c) above on a specified date and the other party has agreed to repurchase the Investment Securities at the same price plus accrued interest on a later date, in which the market value of the Investment Securities purchased is in excess of the amount of the repurchase agreement, and in which the Investment Securities are segregated in a custodial or trust account held either by the Trustee or by a third party (other than the repurchaser) approved by MHESO, as the agent solely of, or in trust solely for the benefit of, the Trustee. The Trustee will notify the Rating Agencies if any repurchase agreement has a maturity of more than 12 months. Repurchase agreements shall be valued at par;

(f) Shares in a no-load investment company registered under the Federal Investment Company Act of 1940 which meets the Investment Rating whose shares are registered under the Federal Securities Act of 1933, whose only investments are obligations described in items (a), (c), (d) or (g), the dollar-weighted average maturity of which, shall not exceed 120 days, and whose investment objectives include seeking to maintain a stable net asset value of \$1 per share. Such obligations shall be valued at par;

(g) Obligations of an agency or instrumentality of the United States which meets the Investment Rating;

(h) Marketable obligations of any state or political subdivision or municipal corporation thereof which (i) are general obligations of MHESO thereof, (ii) are issued by an issuer which has general taxing powers the use of which is pledged or otherwise covenanted to provide sufficient moneys to pay such obligations, and (iii) are rated “Aa” or better by Moody’s and, if rated by Fitch;

(i) Revenue obligations, income from which is not taxable under Section 103(a) of the Code, issued by any state or political subdivision or municipal corporation which are rated “Aa2” or better by Moody’s and if rated by Fitch “AA” and “F-1,” and if such obligations have a short-term rating, the rating is P-1 by Moody’s and if rated by Fitch F-1. Obligations described in items (g), (h) and (i) shall be valued (i) in the absence of a dispute or disagreement by utilizing the market values provided to the Trustee’s mainframe trust accounting system by recognized independent financial services (currently Interactive Data System, Inc.) and (ii) in the event of a dispute or disagreement at the average of the bid and asked price as reported the previous Business Day by The Wall Street Journal (but if such information is unavailable, such obligations shall be valued at the bid price as quoted the previous Business Day by at least two dealers in such obligations selected by MHESO);

(j) Commercial paper rated “P-1” by Moody’s and which matures no more than 270 days after the date of issuance provided that MHESO’s senior unsecured debt is rated “Aa” or better by Moody’s. Such obligations shall be valued at par;

(k) Investment agreements with or guaranteed by institutions whose unsecured debt, investment agreement program or claims paying ability, as the case may be, is rated by at least two of Moody’s, Fitch or Standard & Poor’s Ratings Group (“S&P”) at the time of execution of the agreement, at least “P-1” by Moody’s, “A-1+” by S&P or “F-1” by Fitch for investment agreements having a term of one year or less, at least “P-1” and “A2” by Moody’s, “A-1+” and “A” by S&P or “F-1” and “A” by Fitch for investment agreements having a term of more than one year and less than three years, and at least “P-1” and “Aa2” by Moody’s, “A-1+” and “AA” by S&P or “F-1” and “AA” by Fitch for investment agreements having a term of three years or more or, in each case if either Rating Agency no longer maintains a rating on the Bonds, an equivalent rating by any other nationally recognized bond rating agency then maintaining a rating on the Bonds. Such obligations shall be valued at par;

(l) Any other investment allowed by law and approved in writing in advance by the Credit Provider, Fitch and Moody’s. Such obligations shall be valued at par.

Notwithstanding the foregoing, investments described in subparagraphs (j) and (k) shall not include any “margin security” as such term is defined in Regulation T of the Board of Governors of the Federal Reserve System or any “margin stock” as such term is defined in Regulation G, U or X of the Board of Governors of the Federal Reserve System.

“Investments” has the meaning stated in Treas. Reg. § 1.148-1(b) and includes: (a) any security within the meaning of Code Section 165(g)(2)(A) or (B); (b) any obligation, including United States Treasury bonds, notes, and bills and bank deposits, whether or not certificated or interest bearing, but, except as otherwise provided in Section 148(b)(3)(B) of the Code, excluding obligations the interest on which is, in the Opinion of Bond Counsel, excludable from the gross income of any owner thereof under the Code or the Internal Revenue Code of 1954, as amended to the date of issuance of such obligation; (c) any annuity contract, or any other deferred payment contract acquired to fund an obligation of MHESO; or (d) any other investment-type property.

“Issue Date” means the date a Series of Bonds is delivered to the initial purchasers in exchange for the purchase price of the Series of Bonds.

“Issuer Order” means a written order of MHESO executed by an Authorized Representative, requiring action on the part of any Indenture Agent, and certifying such action is in accordance with the Indenture and any applicable Reimbursement Agreement.

“Kenny Index” means the index most recently made available by Kenny S&P Evaluation Services (“Kenny”) or any successor thereto (the “Indexing Agent”) based upon 30-day yield evaluations at par of securities, the interest on which is excluded from gross income for federal income tax purposes under the Code, of not less than five “Intermediate Grade” component issuers selected by the Indexing Agent which shall include, without limitation, issuers of general obligation bonds. The specific issuers included among the component issuers may be changed from time to time by the Indexing Agent in its discretion. The securities on which the Kenny Index is based shall not include any securities the interest on which is subject to a “minimum tax” or similar tax under the Code, unless all such securities are subject to such tax. In the event that Kenny no longer publishes an index satisfying the above definition of the Kenny Index or the Market Agent reasonably concludes that the Kenny Index will not be announced in a timely manner, then the Market Agent shall announce a rate based upon the same criteria used by Kenny to determine the Kenny Index and the rate announced by the Market Agent for each Auction Date thereafter shall be used in lieu of the Kenny Index for each Auction Date, and such rate announced by the Market Agent shall for all purposes be deemed to be the “Kenny Index” hereunder:

“Liquidity Facility” means, with respect to the 2004 Series A Bonds, any facility designed to provide for the payment of the Purchase Price of any Adjustable Rate Bonds upon tender thereof approved by the Credit Provider, if any, and, with respect to the 2004 Series B Bonds, collectively, the Initial Liquidity Facility, any Alternate Liquidity Facility and any Renewal Liquidity Facility.

“Liquidity Facility Expiration Date” means the Business Day next preceding the day on which the Liquidity Facility shall by its terms expire or will be terminated by the Liquidity Provider and will not be replaced by a Renewal Liquidity Facility.

“Liquidity Provider” means, with respect to the 2004 Series A Bonds, the issuer of a Liquidity Facility approved by the Credit Provider, if any, and, with respect to the 2004 Series B Bonds, the initial Liquidity Provider approved by the Credit Provider for the period during which the initial Liquidity Facility and its related agreements are effective and thereafter shall mean, the entity then obligated under any Alternate Liquidity Facility and its related agreement or any Renewal Liquidity Facility and its related agreement then in effect.

“Loan Capital Fund” means an enterprise fund maintained by MHESO that is the funding source for MHESO’s student loan activities, both present and future.

“Market Agent Agreement” means a Market Agent Agreement, dated as of July 1, 2004, between the Trustee and RBC Dain Rauscher Inc., as the initial Market Agent, and any similar agreement with a successor Market Agent approved by the Credit Provider, in each case as from time to time amended or supplemented and approved by the Credit Provider.



“Maximum Auction Rate”, with respect to the 2004 Series A Bonds, on any date of determination, shall mean the lesser of:

- (i) the Applicable LIBOR Rate plus 1.00%; or
- (ii) the Interest Rate Limitation; or
- (iii) for Auctions after the initial Auction Date, the T-Bill Cap,

and, with respect to the 2004 Series B Bonds, on any date means the lesser of

- (i) the Applicable Percentage of the greater of (a) the After-Tax Equivalent Rate on such date or (b) the Kenny Index on such date;
- (ii) the Interest Rate Limitation; or
- (iii) for Auctions after the Initial Auction Date, the T-Bill Cap.

“MHESO” means the Minnesota Higher Education Services Office, the Issuer under the Indenture.

“Monthly Payment Date” means the fifteenth day of each calendar month, or, if such day is not a Business Day, the next succeeding Business Day.

“Monthly Period” means, with respect to a Monthly Payment Date, the period commencing on such Monthly Payment Date and ending on the last day preceding the next succeeding Monthly Payment Date.

“Moody’s” means Moody’s Investors Service, Inc., its successors and assigns, and, if such entity shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, “Moody’s” shall be deemed to refer to any other nationally recognized securities rating agency designated by MHESO by an Issuer Order, with written notice thereof to the Trustee.

“Opinion of Bond Counsel” means a written opinion from an attorney or firm of attorneys of recognized standing with respect to the tax status of obligations of municipal, state and public agencies, selected by MHESO.

“Opinion of Counsel” means a written opinion of an attorney at law or firm of attorneys selected by the person obliged to deliver an opinion on the subject in question, reasonably acceptable to the person who is to receive the same, duly admitted to the practice of law before the highest court of any state of the United States of America or the District of Columbia.

“Overdue Rate” means, with respect to the 2004 Series A Bonds, on any date of determination, an interest rate per annum equal to the lesser of (a) 200% of the greater of (i) One-Month LIBOR and (ii) AA Composite Commercial Paper Rate, or (b) the Interest Rate Limitation, and, with respect to the 2004 Series B Bonds, on any date of determination, an interest rate per annum equal to the lesser of (a) 200% of the greater of (i) the After-Tax Equivalent Rate and (ii) the Kenny Index, or (b) the Interest Rate Limitation.

“Outstanding” when used with reference to Bonds, shall mean, as of any date, all Bonds, including any Bonds held in custody for the benefit of any Liquidity Provider or Credit Provider, theretofore or thereupon being authenticated and delivered under the General Indenture except: (a) any Bond canceled by the Trustee or delivered to the Trustee for cancellation at or prior to such date; (b) on or after any purchase date for Bonds subject to tender pursuant to the provisions of any Supplemental Indenture, all Bonds or portions thereof (excluding any Bonds held in custody for the benefit of any Liquidity Provider or Credit Provider) which are tendered or deemed to have been tendered for purchase, provided that moneys sufficient for such purchase are on deposit with the Trustee or the tender agent; (c) any Bond in lieu of or in substitution for which other Bonds shall have been authenticated and delivered pursuant to Sections 3.7, 6.6 or 9.6 of the General Indenture; and (d) any Bond paid or deemed to have been paid as provided in Subsection (b) of Section 12.1 of the General Indenture.

“Owner” or “owner” or words of similar import, when used with reference to a Bond, means (i) with respect to and for the purpose of dealing with the Auction Agent in connection with an Auction, a Person who is a Broker-Dealer listed in the books of registry at the close of business on the Business Day immediately preceding such Auction, (ii) with respect to and for the purpose of dealing with the Broker-Dealer in connection with an Auction, a Person is a beneficial owner of 2004 Series A Bonds or 2004 Series B Bonds, and (iii) for all other

purposes, the Person who is the registered owner of such Bond as shown on the registration books maintained by the Registrar.

“Participant” means a member of, or participant in, the Securities Depository.

“Paying Agent” means the Trustee or any other commercial bank or trust company designated as paying agent for the Bonds, and its successor or successors hereafter appointed in the manner in the General Indenture provided and approved by the Credit Provider.

“Payment Default” means (i) a default by MHESO and the Credit Provider in the due and punctual payment of any installment of interest of any Bonds or (ii) a default by MHESO and the Credit Provider in the due and punctual payment of the principal of any Bonds whether at maturity or upon redemption or acceleration.

“Permitted Spread” means the difference between the Yield on the Bonds of a Series and the Student Loans financed with proceeds of the Series as may be required or permitted under the Code.

“Person” means any natural person, firm, partnership, association, corporation, company, government, public body or other entity.

“Potential Owner” means any person, including any Existing Owner, (i) who shall have executed a master purchaser’s letter in the form required by the Broker-Dealer, and (ii) who may be interested in acquiring Bonds bearing interest at an Auction Rate (or, in the case of an Existing Owner thereof, an additional principal amount of Bonds bearing interest at an Auction Rate).

“Principal Installment” means, as of any date of calculation, (i) the aggregate principal amount of Outstanding Bonds due on a certain future date, reduced by the aggregate principal amount of such Bonds which would have been retired by such future date by reason of the payment when due and application in accordance with the Indenture of Sinking Fund Payments payable before such certain future date, plus (ii) any Sinking Fund Payments due on such certain future date, plus (iii) the principal component of the Redemption Price of the Bonds then having been called for redemption on such certain future date.

“Principal Payment Date” means, with reference to any Series or portion of a Series of Bonds, the date upon which a Principal Installment or Sinking Fund Payment on such Bonds becomes payable.

“Program Expenses” means (i) the fees and expenses of each Indenture Agent; (ii) the fees and expenses of a Credit Provider or a Liquidity Provider following the date of issuance of any Class or Series of Bonds for which a Credit Facility or Liquidity Facility is in place; (iii) the fees of the Servicer under any servicing agreement; (iv) the fees and expenses of MHESO incurred in connection with the preparation of Opinions of Counsel and Opinions of Bond Counsel and other authorized reports or statements attributable to the Bonds and the Student Loans acquired under the General Indenture; (v) transfer fees, purchase premiums and loan origination fees on Student Loans held by MHESO and acquired (or by the Trustee on behalf of MHESO); (vi) fees and expenses associated with the delivery of a substitute Credit Facility or Liquidity Facility under a Supplemental Indenture; (vii) fees and expenses associated with (but not payments under) an Interest Rate Exchange Agreement; (viii) the costs of remarketing any of the Adjustable Rate Bonds, which costs shall be limited to (A) fees and expenses of the financial advisors to MHESO in connection with a remarketing, (B) the fees and expenses of attorneys representing the parties in connection with a remarketing (excluding the attorneys for the Credit Provider); (C) the cost of printing in connection with a remarketing, (D) the fees and expenses of Accountants in connection with a remarketing, (E) the fees of any Rating Agency then rating the Bonds, (F) travel expenses of officers and members of MHESO incurred in connection with a remarketing of Adjustable Rate Bonds and the related proceedings taken by MHESO, and (G) miscellaneous reasonable and customary expenses, in each case, as such costs were incurred; and (ix) expenses incurred for MHESO’s maintenance and operation of its Student Loan Program as a direct consequence of the General Indenture, the Bonds or the Student Loans acquired by MHESO under the General Indenture; including the reasonable fees and expenses of attorneys, agents, financial advisors, consultants, accountants and other professionals, attributable to such maintenance and operation. Program Expenses shall not include Costs of Issuance.

“Purchase Date” means any date established for the mandatory or optional tender of Adjustable Rate Bonds, established in accordance with the terms of the applicable Supplemental Indenture.

“Purchase Price” means the price due to a tendering Owner of any Adjustable Rate Bond issued under the General Indenture, being the principal amount thereof, plus interest accrued at the applicable rate or rates to the Purchase Date, unless the Purchase Date is an Interest Payment Date.

“Quarterly Average Auction Rate” shall mean the simple average of the Auction Rates for the Auction Dates preceding the current Auction Date by 91 days or less, including the current Auction Date.

“Quarterly Average T-Bill Rate” shall mean the simple average of the Bond Equivalent Yield of 91-day Treasury bills auctioned in the 91 days preceding (but not including) the current Auction Date.

“Record Date” shall mean the Business Day prior to each Interest Payment Date during an Auction Rate Period and the fifteenth day before each before each Interest Payment Date during the Fixed Rate Period.

“Rating-Agency” means Moody’s, Fitch and any other nationally recognized securities rating agency to the extent such agency has issued and continues to maintain a rating on the Bonds at the time in question, at the request of MHESO. Neither all Bonds issued under the General Indenture, nor all Classes of Bonds that may be issued within a certain Series of Bonds, nor all Bonds within a given Class, need be rated by the same rating agency or agencies.

“Reuters Screen LIBOR Page” means the display designated as page “LIBOR” on the Reuters Monitor Money Rates Service (or such other page as may replace the LIBOR page for the purposes of displaying London interbank offered rates of major banks).

“RAMS” means Reset Auction Mode Securities.

“Rating Confirmation” means a letter from each Rating Agency then providing a rating for particular Bonds, confirming that the action proposed to be taken by MHESO will not, in and of itself, have the effect of reducing, qualifying or withdrawing the rating then applicable to any Bonds.

“Rebate Amount” means as of any Computation Date, the “rebate amount” with respect to a Series of Bonds which are not Federally Taxable Bonds, determined in accordance with Treas. Reg. §1.148-3.

“Rebate Fund” means the fund, if any, by that name created in accordance with Section 5.2 of the General Indenture.

“Record Date” means the Business Day before each Interest Payment Date during an Auction Rate Period and the fifteenth day before each Interest Payment Date during the Fixed Rate Period.

“Redemption Dates” means the date upon which Bonds are to be called for redemption pursuant to the General Indenture.

“Redemption Price” means, with respect to any Bond, the principal amount thereof, plus the applicable premium, if any.

“Reimbursement Agreement” means any Credit Facility agreement or Liquidity Facility agreement by and between MHESO and any Credit Provider or Liquidity Provider with Credit Confirmation with respect to a particular Series or Class of Bonds.

“Repository” means a nationally recognized municipal securities information repository.

“Revenue Fund” means the account by that name created under Section 5.2 of the General Indenture.

“Revenues” means all payments, proceeds, charges and other income received by or on behalf of MHESO from or on account of any Student Loan (including scheduled, delinquent and advance payments of and

any insurance proceeds with respect to, interest received by or on behalf of MHESO with respect to any Student Loan) and all interest and principal earned or gain realized from the investment of amounts in the Funds and Accounts, and all payments received by or on behalf of MHESO pursuant to an Interest Rate Exchange Agreement.

“Second Supplemental Indenture” means the Second Supplemental Indenture, dated as of January 1, 2002, between MHESO and the Trustee.

“Securities Depositor” means The Depository Trust Company and its successors and assigns, or if (i) the Securities Depository resigns from its functions as depository of Bonds or (ii) MHESO, with the prior written consent of the Credit Provider, discontinues use of the Securities Depository, any other securities depository which agrees to follow the procedures required to be followed by a securities depository in connection with Bonds and which is selected by MHESO with the consent of the Trustee, the Auction Agent and the Market Agent.

“SELF I” means the Student Educational Loan Fund I program operated by MHESO.

“SELF II” means the Student Educational Loan Fund II program operated by MHESO.

“SELF III” means the Student Educational Loan Fund III program operated by MHESO.

“Sell Order” shall have the meaning set forth in Section 3.2(a)(i) of Exhibit A to the related Supplemental Indenture.

“Senior Asset Coverage Ratio” means as of any date of calculation, the ratio (expressed as a percentage) of (1) the sum of the value of (a) the Student Loans (valued at par plus accrued interest) credited to the Student Loan Fund, other than Defaulted Student Loans, and (b) all cash and Investment Securities held in the Funds and Accounts (valued as set forth herein or in the General Indenture, plus accrued interest, but excluding amounts irrevocably set aside to pay particular Bonds pursuant to Section 12.1 of the General Indenture) to (2) the sum of the principal and accrued interest on all Outstanding Class I Bonds as defined in the Indenture.

“Series” means all of the Bonds authenticated and delivered upon original issuance in a simultaneous transaction, pursuant to the same Supplemental Indenture and designated as a Series in such Supplemental Indenture regardless of variations in maturity, interest rate, Class, Sinking Fund Payments or other provisions, and any Bonds thereafter authenticated and delivered in lieu of or in substitution for (but not to refund) such Bonds as provided in the General Indenture. For purposes of determining Rebate Amount, Excess Interest, and the permissible Yield on Investments in the Surplus Fund and Acquisition Fund, however, a Series shall mean all of the Bonds (other than Federally Taxable Bonds) authenticated and delivered upon original issuance in a simultaneous transaction or within 15 days, regardless of whether or not they are designated as the same Series in the Supplemental Indenture.

“Series 1992 Bonds” means Minnesota Higher Education Coordinating Board Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992A, the Minnesota Higher Education Coordinating Board Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992B and the Minnesota Higher Education Coordinating Board Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1992C.

“Series 1993 Bonds” means the Minnesota Higher Education Coordinating Board Supplemental Student Loan Program Variable Rate Refunding Revenue Bonds, Series 1993.

“Series 1994 Bonds” means the Minnesota Higher Education Coordinating Board Supplemental Student Loan Program Variable Rate Refunding Revenue Bonds, Series 1994A and the Minnesota Higher Education Coordinating Board Supplemental Student Loan Program Variable Rate Revenue Bonds, Series 1994B.

“Series 1992 Indenture” means the Indenture of Trust dated as of July 1, 1992 as supplemented, between the Minnesota Higher Education Coordinating Board and Norwest Bank Minnesota, National Association, relating to the Series 1992 Bonds.

“Series 1993 Indenture” means the Indenture of Trust dated as of December 1, 1993 as supplemented, between the Minnesota Higher Education Coordinating Board and Norwest Bank Minnesota, National Association, relating to the Series 1993 Bonds.

“Series 1994 Indenture” means the Indenture of Trust dated as of November 1, 1994 as supplemented, between the Minnesota Higher Education Coordinating Board and Norwest Bank Minnesota, National Association, relating to the Series 1994 Bonds.

“2004 Series Bonds” means the 2004 Series A Bonds and the 2004 Series B Bonds.

“2004 Series A Bonds” means the MHESO Supplemental Student Loan Program Revenue Bonds 2004 Series A Bonds (Taxable).

“2004 Series B Bonds” means the MHESO Supplemental Student Loan Program Revenue Bonds 2004 Series B Bonds (Tax-Exempt).

“Servicer” means Nelnet, Inc. f/k/a UNIPAC Service Corporation, whose principal office is located at Suite 400, 315 South Parker Road, Aurora, Colorado 80014 or any other loan servicer approved by each Credit Provider, which approval shall not be unreasonably withheld, if any, and if no Credit Provider is in place, with a Rating Confirmation, or any additional or successor servicer designated with Credit Confirmation in a Supplemental Indenture.

“Services Council” means the Minnesota Higher Education Services Council.

“Servicing Agreement” means each Servicing Agreement as amended from time to time, among MHESO and the Servicer under which such Servicer has agreed to service Student Loans.

“Seventh Supplemental Indenture” means (a) the Seventh Supplemental Indenture, dated as of July 1, 2004, by and between MHESO and the Trustee and (b) if the context so indicates, any Indenture supplemental to or amendatory of the General Indenture, executed by MHESO and the Trustee and effective in accordance with Article VIII of the General Indenture.

“Sinking Fund Payment” means, as of any particular date of calculation, the amount required to be paid by MHESO on a certain future date for the retirement of Outstanding Bonds which mature after said future date, but does not include any amount payable by MHESO by reason of the maturity of a Bond or by call for redemption at the election of MHESO.

“Sixth Supplemental Indenture” means (a) the Sixth Supplemental Indenture, dated as of July 1, 2004, by and between MHESO and the Trustee and (b) if the context so indicates, any Indenture supplemental to or amendatory of the General Indenture, executed by MHESO and the Trustee and effective in accordance with Article VIII of the General Indenture.

“State” means the State of Minnesota.

“Student Loan” or “Loan” means any loans to borrowers under its Supplemental Loan Program (1) purchased, refinanced or originated with moneys in the Acquisition Fund or the Surplus Fund and credited to the Student Loan Fund, (2) received in exchange for other Student Loans upon the sale thereof or substitution therefor in accordance with Section 7.6(e) of the General Indenture or provisions of a Supplemental Indenture and credited to the Student Loan Fund, or (3) otherwise credited to any Fund or Account as part of the Trust Estate, but does not include loans released from the lien of the Indenture and sold or exchanged, as permitted in the Indenture, to any purchaser, including MHESO.

“Student Loan Fund” means the fund by that name created under Section 5.2 of the General Indenture.

“Student Loan Program” means the program for the financing of the acquisition of supplemental student loans pursuant to the Act.

“Submission Deadline” means 1:00 p.m. eastern time on any Auction Date or such other time on any Auction Date by which Broker-Dealers are required to submit Orders to the Auction Agent as specified by the Auction Agent from time to time.

“Submitted Bid” has the meaning set forth in Section 3.2(c)(i) of Exhibit A to the related Supplemental Indenture.

“Submitted Hold Order” has the meaning set forth in Section 3.2(c)(i) of Exhibit A to the related Supplemental Indenture.

“Submitted Order” has the meaning set forth in Section 3.2(c)(i) of Exhibit A to the related Supplemental Indenture.

“Submitted Sell Order” has the meaning set forth in Section 3.2(c)(i) of Exhibit A to the related Supplemental Indenture.

“Subservicer” means any subservicer of Student Loans designated in a Supplemental Indenture for the purposes of Section 7.7 of the General Indenture and approved by the Credit Provider, if any.

“Sufficient Clearing Bids” has the meaning set forth in Section 3.2(c)(i) of Exhibit A to the related Supplemental Indenture.

“Supplemental Loan Program” means any of the loan programs established by MHESO under the Act.

“Surplus Fund” means the fund created under Section 5.2 of the General Indenture.

“Tangible Net Worth” means as of any date of determination, the aggregate net worth, determined in accordance with GAAP, of MHESO, less the book value of all assets of MHESO that would be treated as intangibles under GAAP.

“T-Bill Cap” shall mean, for any Auction Date, the rate (for the then current auction) at which the Quarterly Average Auction Rate equals the Quarterly Average T-Bill Rate plus the Applicable Spread, such rate to be determined by the formula:

$$N \times (T+S) - R,$$

where N is the number of Auction Dates which precede the current Auction date by 91 days or less, including the current Auction Date; T is the Quarterly Average T-Bill Rate; S is the Applicable Spread; and R is the sum of the Auction Rates for Auction Dates preceding the current Auction Date by 91 days or less, excluding the current Auction.

“Trust Estate” means the assets described as such in the granting clauses of the General Indenture.

“Trustee” means Wells Fargo Bank, National Association and its successor or successors and any other person at any time substituted in its place pursuant to the General Indenture with the consent of the Credit Provider, if any.

“Undelivered Bonds” means any Converted Bonds which are required to be tendered on a Fixed Rate Conversion Date and which are not delivered on the Fixed Rate Conversion Date, and for the payment of which there has been irrevocably held in trust in a segregated subaccount for the benefit of such owner an amount of money sufficient to pay the purchase price and any accrued interest owing on the purchase date with respect to such Converted-Bonds.

“Winning Bid Rate” shall have the meaning set forth below in Section 3.2(c)(i) of Exhibit A to the related Supplemental Indenture.

“Yield” of (1) any Investment to any date means the actuarial “yield” of such Investment beginning the date such Investment is allocable to Gross Proceeds, as “yield” is defined in Treas. Reg. § 1.148-5 and (2) the Bonds of a Series means the actuarial “yield” of the Bonds of such Series, as defined in Treas. Reg. § 1.148-4.

## SUMMARIES OF DOCUMENTS

### THE GENERAL INDENTURE

In the General Indenture, MHESO does bargain, assign, pledge and grant a security interest, subject to the use and applications in accordance with the provisions of the Indenture, in order to secure, as therein provided, (i) the payment of the principal or Redemption Price of, and the interest and any Carry-over Amount (and accrued interest thereon) on, the Bonds at any time issued and outstanding under the Indenture according to their tenor and effect, (ii) the performance and observance of all of the covenants and conditions in said Bonds and therein contained, and (iii) the payment of all amounts owing under any Reimbursement Agreement or Interest Rate Exchange Agreement in the following (constituting the “Trust Estate”) to the Trustee: (a) all Student Loans, including any evidence of indebtedness, including agreements and notes, made by Student Loan borrowers and Cosigners and any and all other contracts, instruments and documents executed and/or delivered by the Student Loan borrowers, Cosigners or any other party evidencing, relating to, arising out of or in any way connected with such Student Loans and extensions and renewals thereof; (b) all proceeds of the Bonds, Revenues and any other amounts at any time contained in the Funds and Accounts until their use or release from the Funds and Accounts. Such Bond proceeds, Revenues and other amounts may take the form of moneys, securities, accounts, chattel paper, instruments, and general intangibles; (c) the rights of MHESO in and to the Servicing Agreement as the same relate to Student Loans; and (d) any and all other real or personal property of every name and nature, from time to time hereafter by delivery or by writing of any kind conveyed, mortgaged, pledged, assigned or transferred as and for additional security under by MHESO or by anyone on its behalf or with its written consent to the Trustee, which is hereby authorized to receive any and all such property at any and all times and to hold and apply the same subject to the terms of the General Indenture.

### **Terms of Bonds**

*Limited Obligations of MHESO.* The Bonds are special limited, not general, obligations of MHESO payable solely from the Trust Estate, subject to the application thereof to the purposes and on the conditions permitted by the General Indenture.

*Authorization of Bonds.* In order to (i) purchase, originate or refinance Student Loans, (ii) obtain funds to purchase, originate or refinance additional Student Loans, (iii) refund obligations of MHESO, and (iv) in connection with the foregoing, to set aside the amount MHESO determines is necessary for capitalized interest, a reserve, and to pay Costs of Issuance and initial Program Expenses, obligations of MHESO in the form of Bonds are authorized to be issued from time to time in one or more Series of one or more Classes without limitation as to amount except as may be provided by law. Bonds may be issued as Federally Taxable Bonds only if so provided in the Supplemental Indenture authorizing such Bonds. No Bonds shall be issued under the General Indenture unless they are part of an issue described in a Supplemental Indenture and until the conditions contained in Section 2.5 of the General Indenture are satisfied.

*Conditions Precedent to Delivery of Bonds.* The Bonds of each Series shall be authenticated and delivered upon Order of MHESO, but only upon the receipt by the Trustee of:

(a) a copy of the Supplemental Indenture authorizing such Series, duly executed by the MHESO and the Trustee, which shall specify: (i) the authorized principal amount and designation of such Bonds; (ii) the purposes for which such Bonds are issued, which shall be one or more of the purposes set forth in Section 2.3 of the General Indenture; (iii) the dated dates and maturity dates of such Series of Bonds; (iv) the interest rates or interest component (in the case of Capital Appreciation Bonds) of and principal amounts payable upon such Bonds (or the manner of determining such rates or amounts) and the Interest Payment Dates, if any, and Principal Payment Dates therefor; (v) the denominations of, and the manner of dating, numbering and lettering such Bonds; (vi) the Paying Agents for and the places of payment of such Bonds or the manner of appointing and designating the same; (vii) the amounts required to be deposited in the Debt Service Reserve Fund pursuant to the Debt Service Reserve Requirement, if any; (viii) provisions concerning the forms of such Bonds (including, without

limitation, whether such Bonds shall be delivered in Book-Entry Form) and of the Authenticating Agent's certificate of authentication; (ix) to what funds moneys are to be deposited; (x) any other provisions deemed advisable by MHESO as shall not conflict with the provisions of the General Indenture; (xi) the Redemption Price, if any, of and, subject to the provisions of Article VI of the General Indenture, the redemption terms for such Bonds; (xii) the amounts and due dates of the Sinking Fund Payments, if any, for any of such Bonds; (xiii) the nature and extent of any Credit Facility or Liquidity Facility for any or all of such Bonds, together with the identity of the Credit Provider or Liquidity Provider, if any; (xiv) whether the Bonds of such Series shall be Federally Taxable Bonds; and (xv) the Class of such Series of Bonds with respect to the Trust Estate;

(b) the written consent of each Credit Provider or Liquidity Provider whose Credit Facility or Liquidity Facility secures Bonds of the same or lower priority Class as the Bonds proposed to be issued if the applicable Reimbursement Agreement or Credit Facility requires such consent, provided, however, if the Credit Facility is a bond insurance policy the consent of the Credit Provider shall be required;

(c) an Opinion of Bond Counsel to the effect that (i) the General Indenture and such Supplemental Indenture have been duly authorized, executed and delivered by MHESO and, assuming due authorization, execution and delivery by the other parties thereto, is valid and binding upon MHESO (subject to the operation of bankruptcy, insolvency, preferential transfer, fraudulent transfer, fraudulent conveyance or other laws relating to or affecting creditors rights generally, now existing or hereafter enacted, and by the application of general principles of equity including those relating to equitable subordination and judicial discretion); (ii) such Bonds are valid and binding obligations of MHESO; pursuant to the General Indenture MHESO has assigned and pledged, and all necessary action on the part of MHESO has been taken as required to assign and pledge under the General Indenture, all of the Trust Estate to the Trustee, subject to customary exceptions acceptable to the initial purchasers of the Bonds; (iii) interest on the Bonds is excludable from gross income for federal income tax purposes, in the event that the Bonds are not intended to be Federally Taxable Bonds; (iv) upon the execution, authentication and delivery thereof, such Bonds will have been duly and validly authorized and issued in accordance with the constitution and statutes of the State and with the General Indenture; and (v) the Bonds will be classified as debt for federal income tax purposes;

(d) a written order as to the delivery of such Bonds, signed by an Authorized Representative;

(e) in the event that there are then other Bonds Outstanding under the General Indenture, (i) a Rating Confirmation and Credit Confirmation with respect to all other Bonds Outstanding, and (ii) on the date of issuance and delivery of any additional Bonds, a certification of an Authorized Representative to the effect that MHESO is not then in default in the performance of any of the covenants; conditions, agreements or provisions contained in the General Indenture, unless the issuance of such additional Bonds and the application of the proceeds thereof is intended to, and will, cure such default upon the issuance of such additional Bonds; and

(f) such further documents, certificates, instruments and moneys as are required by any Supplemental Indenture entered into pursuant to Article VIII or IX of the General Indenture.

The Trustee shall notify MHESO of its receipt of proceeds from a Series of Bonds and shall deposit them to the funds provided in the Supplemental Indenture.

### **Pledge of Indenture, Establishment of Funds and Accounts**

*Pledge Effected by Indenture, Priority.* The Trust Estate is pledged in accordance with the Recitals and the Granting Clauses of the General Indenture. To the fullest extent provided by applicable law, the money and property pledged shall immediately be subject to the lien of such pledge and such lien shall be valid and binding against all parties having claims in tort, contract or otherwise against MHESO, irrespective of whether such parties have notice of the pledge.

*Creation of Funds.* The General Indenture creates and establishes the following Funds to be held by the Trustee and maintained in accordance with the provisions of the General Indenture: (a) Student Loan Fund; (b) Revenue Fund within which there may be a Capitalized Interest Subaccount; (c) Surplus Fund; (d) Debt Service Reserve Fund; (e) Acquisition Fund; and (f) Credit Proceeds Fund. Upon Issuer Order, the Trustee shall create and establish a Rebate Fund and Excess Interest Fund, both of which shall be held by the Trustee but shall be



outside of the Trust Estate, and the Owners, any Credit Provider and any Liquidity Provider shall have no right, title, or interest therein or thereto. The Trustee is authorized for the purpose of facilitating administration of the Trust Estate to create subaccounts in any of the various Funds established under the General Indenture.

*Student Loan Fund.* The Trustee shall credit all Student Loans transferred to the Trustee from other trust estates of MHESO or otherwise by MHESO to the Trustee and all Student Loans made by MHESO with amounts provided under the General Indenture to the Student Loan Fund. The Student Loan Fund shall hold only Student Loans and no other assets of any kind whatsoever. MHESO may elect to create two or more subaccounts in the Student Loan Fund. If subaccounts are created to separate Student Loans purchased, originated or refinanced with Gross Proceeds derived from one or more Series of Bonds, MHESO will notify the Trustee which Student Loans should be credited to each subaccount.

MHESO and the Trustee shall execute and cause to be filed UCC financing statements (and continuation statements) and/or custodian agreements as directed by MHESO all as shall be necessary under applicable law to perfect and maintain the security interest created by the General Indenture in the Student Loans. Following the filing of any UCC financing statement with respect to the General Indenture the Trustee agrees to notify MHESO six months prior to the expiration of such filing of the need to file continuation statements, and to the extent permitted by law, the Trustee shall execute and file such continuation statements without further direction from MHESO.

Student Loans held under the General Indenture shall be sold or exchanged by the Trustee free from the lien of the General Indenture at any time pursuant to Section 7.6 of the General Indenture or the provisions of a Supplemental Indenture if the Trustee is provided the following: (a) a Certificate signed by MHESO demonstrating compliance with Section 7.6(c) of the General Indenture, if required; (b) such documentation as may be required by the applicable Supplemental Indenture; and (c) the purchase price or Student Loan to be exchanged therefor, as applicable. The Trustee shall apply such purchase price in accordance with the provisions of Section 5.4 of the General Indenture.

Notwithstanding the foregoing, MHESO shall not direct the Trustee to sell Student Loans if such sale would have an adverse effect on the exclusion from gross income of interest on the Bonds (other than Federally Taxable Bonds) for federal income tax purposes and shall receive a Favorable Opinion prior to such sale.

*Revenue Fund.*

On each Monthly Payment Date (or on such other date as is specified in a particular clause), money in the Revenue Fund shall be applied in the following order of priority subject to the terms in the Supplemental Indenture:

(a) Amounts which, when added to the amounts already in the Rebate Fund and the Excess Interest Fund, equal the Rebate Amount and the Excess Interest, respectively, as of the most recent date of calculation, shall be transferred to the Rebate Fund and the Excess Earnings Fund, as appropriate,

(b) Thereafter, (1) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any fees or expenses due and payable to the Servicer as of the end of the preceding calendar month have been paid from a source other than the Trust Estate, an amount equal to such fees and expenses, together with any required late fees or interest thereon, shall be paid to the Servicer, and (2) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has failed to pay any fees and ordinary expenses due and payable to the Trustee as of the end of the preceding calendar month, an amount equal to such fees and expenses shall be paid to the Trustee;

(c) Thereafter, (1) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any premium or fee due and payable to a Credit Provider with respect to a Credit Facility or a Liquidity Provider with respect to a Liquidity Facility relating to Class I Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such premium or fee, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Liquidity Provider; (2) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has certified that any fee due and payable to an Indenture Agent (other than the Trustee) with respect to Class I

Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such fee, together with any required late fee or interest thereon, shall be paid to the Indenture Agent; (3) any amount due during the related Monthly Period from MHESO pursuant to any Interest Rate Exchange Agreement with respect to Class I Bonds (which, for purposes of estimating such amount only, will be calculated assuming all relevant rates are the same as the most current rates for any portion of such period for which such rates have yet to be determined) shall be paid to the counterparty when due; (4) an amount equal to interest on Class I Bonds shall be accounted for as follows: (A) to the extent interest on Class I Bonds is payable during the related Monthly Period, an amount equal to such interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class I Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such interest when due; and (B) to the extent any interest on Class I Bonds will accrue but not be payable during the related Monthly Period, an amount equal to such accruing interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class I Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall be retained in the Revenue Fund; (5) an amount equal to all principal payable on Class I Bonds during the related Monthly Period shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such principal when due; (6) an amount sufficient to reimburse a Credit Provider for any claims or draws on its Credit Facility to pay interest and principal on any Class I Bonds, together with any required interest thereon, shall be paid to such Credit Provider; (7) to the extent other available moneys are insufficient therefor, an amount sufficient to pay the Purchase Price of any Class I Bond on the related Purchase Date shall be applied to the payment of such Purchase Price when due; (8) an amount sufficient to reimburse a Liquidity Provider for any draws on its Liquidity Facility to pay the Purchase Price of any Class I Bond, together with any required interest thereon, shall be paid to such Liquidity Provider; and (9) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any other amount is due and payable to a Credit Provider or an Indenture Agent (other than the Trustee) with respect to Class I Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such amount, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Indenture Agent, as appropriate; and

(d) Thereafter, (1) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any premium or fee due and payable to a Credit Provider with respect to a Credit Facility or a Liquidity Provider with respect to a Liquidity Facility relating to Class II Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such premium or fee, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Liquidity Provider; (2) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has certified that any fee due and payable to an Indenture Agent (other than the Trustee) with respect to Class II Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such fee, together with any required late fee or interest thereon, shall be paid to the Indenture Agent; (3) any amount due during the related Monthly Period from MHESO pursuant to any Interest Rate Exchange Agreement with respect to Class II Bonds (which, for purposes of estimating such amount only, will be calculated assuming all relevant rates are the same as the most current rates for any portion of such period for which such rates have yet to be determined) shall be paid to the counterparty when due; (4) an amount equal to interest on Class II Bonds shall be accounted for as follows: (A) to the extent interest on Class II Bonds is payable during the related Monthly Period, an amount equal to such interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class II Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such interest when due; and (B) to the extent any interest on Class II Bonds will accrue but not be payable during the related Monthly Period, an amount equal to such accruing interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class II Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall be retained in the Revenue Fund; (5) an amount equal to all principal payable on Class II Bonds during the related Monthly Period shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such principal when due; (6) an amount sufficient to reimburse a Credit Provider for any claims or draws on its Credit Facility to pay interest and principal on any Class II Bonds, together with any required interest thereon, shall be paid to such Credit Provider; (7) to the extent other available moneys are insufficient therefor, an amount sufficient to pay the Purchase Price of any Class II Bond on the related Purchase Date shall be applied to the payment of such Purchase Price when due; (8) an amount sufficient to reimburse a Liquidity Provider for any draws on its Liquidity Facility to pay the Purchase Price of any Class II Bond, together with any

required interest thereon, shall be paid to such Liquidity Provider; and (9) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any other amount is due and payable to a Credit Provider or an Indenture Agent (other than the Trustee) with respect to Class II Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such amount, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Indenture Agent, as appropriate; and

(e) Thereafter, (1) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any premium or fee due and payable to a Credit Provider with respect to a Credit Facility or a Liquidity Provider with respect to a Liquidity Facility relating to Class III Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such premium or fee, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Liquidity Provider; (2) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has certified that any fee due and payable to an Indenture Agent (other than the Trustee) with respect to Class III Bond as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such fee, together with any required late fee or interest thereon, shall be paid to the Indenture Agent; (3) any amount due during the related Monthly Period from MHESO pursuant to any Interest Rate Exchange Agreement with respect to Class III Bonds (which, for purposes of estimating such amount only, will be calculated assuming all relevant rates are the same as the most current rates for any portion of such period for which such rates have yet to be determined) shall be paid to the counterparty when due; (4) an amount equal to interest on Class III Bonds shall be accounted for as follows: (A) to the extent interest on Class III Bonds is payable during the related Monthly Period, an amount equal to such interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class III Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such interest when due; and (B) to the extent any interest on Class III Bonds will accrue but not be payable during the related Monthly Period, an amount equal to such accruing interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class III Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall be retained in the Revenue Fund; (5) an amount equal to all principal payable on Class III Bonds during the related Monthly Period shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such principal when due; (6) an amount sufficient to reimburse a Credit Provider for any claims or draws on its Credit Facility to pay interest and principal on any Class III Bonds, together with any required interest thereon, shall be paid to such Credit Provider; (7) to the extent other available moneys are insufficient therefor, an amount sufficient to pay the Purchase Price of any Class III Bond on the related Purchase Date shall be applied to the payment of such Purchase Price when due; (8) an amount sufficient to reimburse a Liquidity Provider for any draws on its Liquidity Facility to pay the Purchase Price of any Class III Bond, together with any required interest thereon, shall be paid to such Liquidity Provider; and (9) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any other amount is due and payable to a Credit Provider or an Indenture Agent (other than the Trustee) with respect to Class III Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such amount, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Indenture Agent, as appropriate; and

(f) Thereafter, (1) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any premium or fee due and payable to a Credit Provider with respect to a Credit Facility or a Liquidity Provider with respect to a Liquidity Facility relating to Class IV Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such premium or fee, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Liquidity Provider; (2) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has certified that any fee due and payable to an Indenture Agent (other than the Trustee) with respect to Class IV Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such fee, together with any required late fee or interest thereon, shall be paid to the Indenture Agent; (3) any amount due during the related Monthly Period from MHESO pursuant to any Interest Rate Exchange Agreement with respect to Class IV Bonds (which, for purposes of estimating such amount only, will be calculated assuming all relevant rates are the same as the most current rates for any portion of such period for which such rates have yet to be determined) shall be paid to the counterparty when due; (4) an amount equal to interest on Class IV Bonds shall be accounted for as follows: (A) to the extent interest on Class IV Bonds is payable during the related Monthly Period, an amount equal to such interest (which, for purposes of estimating such amount only, will be assumed

to be at the maximum allowable rate thereon as to any Class IV Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such interest when due; and (B) to the extent any interest on Class IV Bonds will accrue but not be payable during the related Monthly Period, an amount equal to such accruing interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon-as to any Class IV Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall be retained in the Revenue Fund; (5) an amount equal to all principal payable on Class IV Bonds during the related Monthly Period shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such principal when due; (6) an amount sufficient to reimburse a Credit Provider for any claims or draws on its Credit Facility to pay interest and principal on any Class IV Bonds, together with any required interest thereon, shall be paid to such Credit Provider; (7) to the extent other available moneys are insufficient therefor, an amount sufficient to pay the Purchase Price of any Class IV Bond on the related Purchase Date shall be applied to the payment of such Purchase Price when due; (8) an amount sufficient to reimburse a Liquidity Provider for any draws on its Liquidity Facility to pay the Purchase Price of any Class IV Bond, together with any required interest thereon, shall be paid to such Liquidity Provider; and (9) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any other amount is due and payable to a Credit Provider or an Indenture Agent (other than the Trustee) with respect to Class N Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such amount, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Indenture Agent, as appropriate; and

(g) Thereafter, (1) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any premium or fee due and payable to a Credit Provider with respect to a Credit Facility or a Liquidity Provider with respect to a Liquidity Facility relating to Class V Bonds as of the end of the preceding calendar month has been paid from a source, other than the Trust Estate, an amount equal to such premium or fee, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Liquidity Provider; (2) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has certified that any fee due and payable to an Indenture Agent (other than the Trustee) with respect to Class V Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such fee, together with any required late fee or interest thereon, shall be paid to the Indenture Agent; (3) any amount due during the related Monthly Period from MHESO pursuant to any Interest Rate Exchange Agreement with respect to Class V Bonds (which, for purposes of estimating such amount only, will be calculated assuming all relevant rates are the same as the most current rates for any portion of such period for which such rates have yet to be determined) shall be paid to the counterparty when due; (4) an amount equal to interest on Class V Bonds shall be accounted for as follows: (A) to the extent interest on Class V Bonds is payable during the related Monthly Period, an amount equal to such interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class V Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such interest when due; and (B) to the extent any interest on Class V Bonds will accrue but not be payable during the related Monthly Period, an amount equal to such accruing interest (which, for purposes of estimating such amount only, will be assumed to be at the maximum allowable rate thereon as to any Class V Bond for any portion of such period for which the applicable interest rate has yet to be determined) shall be retained in the Revenue Fund; (5) an amount equal to all principal payable on Class V Bonds during the related Monthly Period shall, subject to Section 5.5 of the General Indenture, be applied to the payment of such principal when due; (6) an amount sufficient to reimburse a Credit Provider for any claims or draws on its Credit Facility to pay interest and principal on any Class V Bonds, together with any required interest thereon, shall be paid to such Credit Provider; (7) to the extent other available moneys are insufficient therefor, an amount sufficient to pay the Purchase Price of any Class V Bond on the related Purchase Date shall be applied to the payment of such Purchase Price when due; (8) an amount sufficient to reimburse a Liquidity Provider for any draws on its Liquidity Facility to pay the Purchase Price of any Class V Bond, together with any required interest thereon, shall be paid to such Liquidity Provider; and (9) subject to the limitations, if any, contained in a Supplemental Indenture, if MHESO has not certified that any other amount is due and payable to a Credit Provider or an Indenture Agent (other than the Trustee) with respect to Class V Bonds as of the end of the preceding calendar month has been paid from a source other than the Trust Estate, an amount equal to such amount, together with any required late fee or interest thereon, shall be paid to the Credit Provider or Indenture Agent, as appropriate; and

(h) Thereafter, (1) to the extent necessary to increase the balance therein to the Debt Service Reserve Requirement, a transfer shall be made to the Debt Service Reserve Fund; (2) if, as of any Interest Payment Date, any Carry-over Amount (including any accrued interest thereon) is due and payable with respect to a series of Bonds, as provided in the related Supplemental Indenture, the Trustee shall (to the extent amounts are available therefor) (a)

pursuant to this clause, or (b) in the Surplus Fund after taking into account all other amounts payable therefrom on such Interest Payment Date); an amount equal to such Carry-over Amount (including any accrued interest thereon) shall be paid to the applicable Bondholders in the following order of priority: (1) to the payment of any Carry-over Amount on Class I Bonds; (2) to the payment of any Carry-over Amount on Class II Bonds; (3) to the payment of any Carry-over Amount on Class III Bonds; (4) to the payment of any Carry-over Amount on Class IV Bonds; and (6) to the payment of any Carry-over Amount on Class V Bonds; (7) at the written direction of MHESO, any portion or all of the remaining money shall be applied to the purchase or making of Student Loans, as more fully set forth in Section 5.9; and (8) any money remaining after the foregoing applications shall be transferred to the Surplus Fund.

In the event amounts are payable to more than one Person pursuant to any of the preceding clauses, and the money available is insufficient to pay all such amounts, the available money shall be applied pro rata to the payment of each Person based upon the amount payable thereto. If the Trustee receives notice, either from the Servicer or MHESO, that amounts described in clause (b)(1) above have not been paid, and moneys available to pay such amounts under the General Indenture are insufficient to do so, the Trustee shall immediately notify all Credit Providers in writing.

MHESO shall provide the Trustee with a Certificate on or before the tenth day of each calendar month setting forth (A) the amounts due and owing as fees and expenses to the Servicer and each Indenture Agent and as premiums, fees and other amounts (other than reimbursement for claims or draws on the related Credit Facility) to each Credit Provider as of the end of the preceding calendar month, and (B) such portions of each such amount as have been previously paid by MHESO. The Trustee will be entitled to rely on such Certificate in determining whether moneys in the Revenue Fund will be applied to the payment of such amounts in accordance with the foregoing provisions of this Section.

MHESO may elect to create two or more subaccounts in the Revenue Fund; each for the deposit of Gross Proceeds derived from a Series of Bonds (or portion thereof), as determined by MHESO. If MHESO makes such election, the Trustee shall pay Debt Service on the Bonds of that Series or portion thereof (or shall reimburse the Credit Provider for payment of such Debt Service) from that Series' subaccount and to the extent possible, shall pay expenses attributable to that Series of Bonds from that Series' subaccount. Notwithstanding the foregoing, in the event there are insufficient funds in the Revenue Fund subaccount and Surplus Fund subaccount for a particular Series of Bonds to pay any amount then due, the Trustee shall make such payment from the Revenue Fund subaccount or Surplus Fund subaccount for another Series of Bonds, to the extent there are sufficient moneys to do so after satisfying all amounts required to be paid (without regard to subaccounts) prior to the amount due, in the order established in the General Indenture, provided, however, that funds for a Credit Facility that is an insurance policy can only be used to pay Bonds of the Series for which it was issued.

*Credit Proceeds Fund.* The first source of payment of principal and interest on a Series of Bonds secured by a Credit Facility that is not a bond insurance policy shall be the designated subaccount in the Credit Proceeds Fund. The Trustee shall deposit into the designated subaccount of the Credit Proceeds Fund the proceeds of each drawing on that Credit Facility (other than drawings to provide the Purchase Price of Tendered Bonds) immediately upon receipt. The Trustee shall draw under such Credit Facility in accordance with its terms in time and amount sufficient to provide for the payment of principal of and interest on the Bonds secured by that Credit Facility on each Bond Payment Date, whether at maturity or upon earlier proceedings for redemption or acceleration, or otherwise; in an amount equal to the full amount of the interest or principal coming due on such date with respect to all such Bonds then Outstanding (except with respect to Bonds then registered to the order or in the name of such Credit Provider or the Issuer). The Trustee shall, following deposit of such proceeds into the Credit Proceeds Fund, apply the amounts in such Fund solely to pay such principal and interest on the related Bonds as they become due. Amounts on deposit in the Credit Proceeds Fund shall not be commingled with any other fund or account established hereunder. The Trustee shall have the sole right of withdrawal from the Credit Proceeds Fund, and the Issuer shall have no legal, beneficial or equitable right, title or interest therein. The Credit Proceeds Fund is established solely for the benefit of the Owners (except MHESO and the Credit Provider as to Bonds purchased with the proceeds of drawings under that Credit Facility), from time to time, of the Bonds secured by a Credit Facility. The Trustee shall have no lien on amounts on deposit in the Credit Proceeds Fund for payment of its fees or expenses. Notwithstanding anything contained herein to the contrary, the Trustee shall only make payments of principal or Redemption Price or Purchase Price of (to the extent remarketing proceeds are not available for such purposes) and interest on Bonds secured by a Credit Facility, first, from moneys drawn from the Credit Facility and, if insufficient,

then from other moneys in the Funds and Accounts established under the General Indenture. The Trustee shall not require any indemnity as a condition to presenting a draw certificate under the Credit Facility.

*Surplus Fund.* The Trustee shall deposit in the Surplus Fund all amounts required to be transferred thereto from the Revenue Fund and, except as directed in any Supplemental Indenture, all amounts transferred from any other trust estate of MHESO. The moneys in the Surplus Fund shall be invested in Investment Securities as provided in Section 5.15 of the General Indenture, and any earnings on or income from such investments shall be deposited in the Revenue Fund. Except with respect to Federally Taxable Bonds and as otherwise permitted in a Supplemental Indenture or a tax certificate delivered in connection with the issuance of a Series of Bonds, MHESO will not direct the Trustee to invest money in the Surplus Fund in any Investment, if as a result of such investment the Yield from the Issue Date of a Series of Bonds of all Investments acquired with money in the Surplus Fund derived from proceeds of such Series, whether then held or previously disposed of, exceeds the Yield of the Series. Notwithstanding the foregoing, money in the Surplus Fund may also be used to purchase Student Loans.

The Trustee shall use the moneys in the Surplus Fund for the following purposes in the following order of priority: (a) make deposits to the Excess Earnings Fund and the Rebate Fund to the extent required by Sections 5.10, 5.11 and 5.12 of the General Indenture, as applicable; (b) to the extent there is a required deposit or transfer on any date from the Revenue Fund and the moneys therein are not sufficient therefor, the moneys in the Surplus Fund shall be utilized to satisfy such deficiency (including for the payment of amounts due with respect to the Bonds or to reimburse a Credit Provider for such payments); (c) If a “Term-Out Event” is declared in accordance with the applicable Reimbursement Agreement, on each July 1 after a Term-Out Event to redeem Credit Provider Bonds; (d) on any date, to purchase, originate or refinance Student Loans, as more fully set forth in Section 5.9 of the General Indenture; and (e) to transfer money to MHESO if permitted pursuant to Section 5.17 of the General Indenture, provided MHESO has Credit Confirmation and gives notice to each Rating Agency.

MHESO may elect to create two or more subaccounts in the Surplus Fund; each for Gross Proceeds derived from a Series of Bonds (or portion thereof) as determined by MHESO. If MHESO makes such election, the Trustee shall pay Debt Service on the Bonds of that Series or portion thereof (or shall reimburse the Credit Provider for payment of such Debt Service) from that Series’ subaccount and, to the extent possible, shall pay expenses attributable to that Series of Bonds from that Series’ subaccount. Notwithstanding the foregoing, in the event there are insufficient funds in the Revenue Fund subaccount and Surplus Fund subaccount for a particular Series of Bonds to pay any amount then due, the Trustee shall make such payment from the Revenue Fund subaccount or Surplus Fund subaccount for another Series of Bonds, to the extent there are sufficient moneys to do so after satisfying all amounts required to be paid (without regard to subaccounts) prior to the amount due, in the order of priority established in this Section and Section 5.4 of the General Indenture.

*Debt Service Reserve Fund.* The Trustee shall deposit in the Debt Service Reserve Fund the Debt Service Reserve Requirement specified in the Supplemental Indentures and any transfers thereto from the Revenue Fund or Surplus Fund. Amounts on deposit in the Series Subaccount of the Debt Service Reserve Fund shall be applied in conjunction with the final payment of the principal of and interest on the last Outstanding Bonds of a Series. To the extent moneys on deposit in the Debt Service Reserve Fund exceed the Debt Service Reserve Requirement, as required under a Supplemental Indenture, MHESO shall by Corporation Order direct the Trustee to transfer such excess, and all earnings thereon, to the Surplus Fund.

*Acquisition Fund.* Moneys in the Acquisition Fund shall be used to purchase or make Student Loans and to the extent provided in a Supplemental Indenture to pay Costs of Issuance and initial Program Expenses, at or about the time of issuance of a Series of Bonds.

*Purchase Fund.* The Purchase Fund is a fund to be held by the Tender Agent. The Tender Agent shall deposit to the credit of the Purchase Fund only the following promptly upon receipt: (a) the Purchase Price of tendered Bonds or Undelivered Bonds sold pursuant to a remarketing agreement (other than to MHESO), and (b) all amounts derived from a Credit Facility or Liquidity Facility to purchase tendered Bonds or Undelivered Bonds. The Tender Agent shall disburse amounts held for the credit of the Purchase Fund to purchase Bonds, on behalf of the persons purchasing the same. No Bonds shall be remarketed to MHESO by any remarketing agent.

## Particular Covenants

In the General Indenture, MHESO covenants and agrees with the Trustee and the Owners of the Bonds as follows:

*Payment of Bonds.* MHESO shall duly and punctually pay or cause to be paid the principal or Redemption Price of every Bond and the interest, if any, thereon and any Carry-Over Amounts (together with interest thereon), at the dates and places and in the manner stated in the Bonds, according to the true intent and meaning thereof.

### *Student Loan Program.*

(a) MHESO shall, or through its Servicers shall, diligently collect all principal and interest payments on all the Student Loans held under the Indenture (except to the extent loans are forgiven by MHESO), and insurance and guarantee claims, if any, which relate to such Student Loans. MHESO will comply with the provisions of Act, which apply to the Student Loan Program and to such Student Loans.

(b) No amount in the Acquisition Fund, the Revenue Fund, or the Surplus Fund shall be expended or applied for the purpose of purchasing, originating or refinancing a Student Loan, and no Student Loan shall be financed under the Indenture, unless MHESO has determined that as of the date of acquisition of such Student Loan each of the representations in Section 7.13 of the General Indenture is true.

(c) MHESO may at any time sell, assign, transfer or otherwise dispose of a Student Loan at a price: (i) in excess of the principal amount thereof (plus accrued borrower interest) or, except as to Student Loans contributed by MHESO, in excess of the purchase price paid by MHESO for such Student Loan (less principal amounts received with respect to such Student Loan); (ii) equal to the principal amount thereof (plus accrued borrower interest), when the amounts on deposit in the Funds and Accounts and the Student Loans in the Student Loan Fund, are at least equal to the principal amount of the Outstanding Bonds plus accrued interest or in order to pay current Debt Service on the Bonds or to avoid any default in the payment obligations of MHESO under any Reimbursement Agreement, Credit Facility or otherwise; or (iii) lower than the principal amount thereof (plus accrued interest) when MHESO delivers to the Trustee and the Credit Provider, if any, and each Rating Agency a Cash Flow Projection demonstrating that, after any such disposition, the Cash Flow Condition will be satisfied.

(d) MHESO will use its best efforts to evaluate the reinvestment of principal and interest receipts with respect to Student Loans to ensure that it will continue to be able to fulfill its debt service requirements under the General Indenture.

(e) MHESO may exchange with any purchaser one or more Student Loans for one or more other Student Loans (of approximately the same aggregate principal amount and accrued interest) of a borrower who is the obligor on other Student Loans. MHESO may at any time and from time to time exchange Student Loans for other Student Loans having an aggregate principal amount and interest rate not less than the aggregate principal amount and interest rate of the Student Loans being exchanged, for the purpose of consolidating Student Loans of a single borrower within one indenture.

*Servicing of Student Loans.* MHESO shall duly and properly service all Student Loans and enforce the payment and collection of all payments of principal and interest or shall cause such servicing to be done by the Servicer or any additional or successor Servicer evidencing, in the judgment of MHESO, the capability and experience necessary to adequately service Student Loans. MHESO covenants that the Servicer will be its agent and subject to its general direction under a contract with the Servicer. The Servicer may perform its duties through Subservicers, except as may be provided by any Supplemental Indenture. The Servicer shall be responsible for the performance of its obligations under the Indenture and the Servicing Agreement, whether such obligations are performed by the Servicer or by a Subservicer, and the Servicer shall be responsible for any fees and payments required by the Subservicer. MHESO shall cause all Student Loan notes to be held in trust as part of the Trust Estate subject to the lien of the Indenture.

## **Supplemental Indentures Not Requiring Consent Of Owners**

For any one or more of the following purposes and at any time or from time to time subject to the provisions of the General Indenture, a Supplemental Indenture not requiring the consent of Owners may be executed and delivered by MHESO and the Trustee for the following purposes:

(a) to close the General Indenture, or provide limitations and restrictions in addition to the limitations and restrictions contained in the General Indenture on, the authentication and delivery of Bonds or the issuance of other evidences of indebtedness; (b) to add to the covenants and agreements of MHESO in the General Indenture other covenants and agreements to be observed by MHESO which are not contrary to or inconsistent with the General Indenture as theretofore in effect; (c) to add to the limitations and restrictions in the General Indenture other limitations and restrictions to be observed by MHESO which are not contrary to or inconsistent with the General Indenture as theretofore in effect; (d) to surrender any right, power or privilege reserved to or conferred upon MHESO by the terms of the General Indenture, but only if the surrender of such right, power or privilege is not contrary to or inconsistent with the covenants and agreements of MHESO contained in the General Indenture; (e) to confirm, as further assurance, any pledge under, and the subjection to any lien or pledge created or to be created by, the General Indenture, of the Revenues or of any other revenues or assets; (f) to modify any of the provisions of the General Indenture in any respect whatever, but only if (i) such modification shall be, and be expressed to be, effective only after all Bonds Outstanding at the date of the execution of such Supplemental Indenture shall cease to be Outstanding, and (ii) such Supplemental Indenture shall be specifically referred to in the text of all Bonds authenticated and delivered after the date of the execution of such Supplemental Indenture and of Bonds issued in exchange therefor or in place thereof; (g) to authorize the issuance of one or more Series of Bonds and to prescribe the terms and conditions upon which such Bonds may be issued; (h) to create additional special trust accounts for the further securing of all Bonds or all Bonds of a Class or Series issued pursuant to the General Indenture if along with such Supplemental Indenture there is filed an Opinion of Bond Counsel to the effect that the creation and operation of such account will in no way impair the existing security of the Owner of any Outstanding Bond; (i) to cure any ambiguity, supply any omission, or cure or correct any defect or inconsistent provisions in the General Indenture; (j) to insert such provisions clarifying matters or questions arising under the General Indenture as are necessary or desirable and are not contrary to or inconsistent with the General Indenture as theretofore in effect; (k) to provide for additional duties of the Trustee in connection with the Student Loans; (l) to satisfy the requirements of a Rating Agency in order to obtain, maintain or improve the rating on any of the Bonds; (m) to provide for the orderly sale or remarketing of Bonds; (n) to make any other change which, in the judgment of the Trustee acting in reliance on an Opinion of Bond Counsel is necessary or desirable to maintain the tax status of the Bonds (other than Federally Taxable Bonds); (o) to make any change which, in the judgment of the Trustee acting in reliance upon an Opinion of Counsel, to the extent the Trustee deems such opinion desirable, is not to the prejudice of the Trustee or the Owners; or (p) to make any change that affects only the rights of a Credit Provider or Liquidity Provider which has issued a Credit Facility or Liquidity Facility with respect to any of the Bonds, with the prior written consent of such Credit Provider or Liquidity Provider.

## **Supplemental Indentures Requiring Consent Of Owners**

*Powers of Amendment.* Except as provided in Article VIII of the General Indenture, any modification of or amendment to the General Indenture and of the rights and obligation of MHESO, a Credit Provider or Liquidity Provider under a Supplemental Indenture, and of the Owners of the Bonds of any particular Series, may be made by a Supplemental Indenture, with the written consent: (i) of the Owners of at least 51% in principal amount of the Bonds By Class in Descending Priority Outstanding at the time such consent is given; (ii) any Credit Provider; (iii) in case less than all of the several Series of Bonds then Outstanding are affected by the modification or amendment, of the Owners of at least 51% in aggregate principal amount of the Bonds of each Series so affected and outstanding at the time such consent is given, and (iv) in case the modification or amendment changes the terms of any Sinking Fund Payment, of the Owners of at least 100% in principal amount of the Bonds of the particular Class, Series and maturity entitled to such Sinking Fund Payment and Outstanding at the time such consent is given. In the event that a Credit Provider has issued a Credit Facility or a Liquidity Provider has issued a Liquidity Facility respecting all of a Series of Bonds or Class within that Series of Bonds and unless the Credit Provider or Liquidity Provider is then in receivership; bankruptcy or reorganization or is then continuing wrongfully to dishonor drawings under the Credit Facility or Liquidity Facility, the Credit Provider or, in the event there is no Credit Provider, the Liquidity Provider



shall be considered as the Owner of 100% of such Series of Bonds or Class within that Series of Bonds for the purpose of consenting to any modification of or amendment to the Indenture, but, if so required by the applicable Reimbursement Agreement in the case of the Liquidity Provider only.

If any such modification or amendment will not take effect so long as any Bonds of any specified maturity remain Outstanding, however, the consent of the Owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under Section 9.2 of the General Indenture. No such modification or amendment shall permit a change in the terms of redemption or maturity of the principal of any Outstanding Bond or of any installment of interest thereon or a reduction in the principal amount or the Redemption Price thereof or in the rate of interest thereon without the consent of the Owner of such Bond (which consent shall not be deemed to be effected by a Credit Provider or Liquidity Provider), or shall reduce the percentages or otherwise affect the Classes of Bonds, the consent of the Owners of which is required to effect any such modification or amendment, or shall change or modify any of the rights or obligations of any Indenture Agent without its written assent thereto. For the purposes of Section 9.2 of the General Indenture, a Series shall be deemed to be affected, by a modification or amendment of the General Indenture if the same adversely affects or diminishes the rights of the Owners of Bonds of such Series. The Trustee may in its sole discretion determine whether or not in accordance with the foregoing powers of amendment, Bonds of any particular Series or maturity would be affected by any modification or amendment of the General Indenture and any such determination shall be binding and conclusive on MHESO, any Credit Provider or Liquidity Provider and all Owners of Bonds.

## **Defaults And Remedies**

*Events of Default.* Each of the following events is an “Event of Default:”

- (a) payment of the principal, Purchase Price, or Redemption Price, if any, on any Bond shall not be made when and as the same shall become due, whether at maturity or upon call for redemption or otherwise; or
- (b) payment of any installment of interest on any of the Bonds shall not be made when and as the same shall become due; or
- (c) MHESO shall fail or refuse to comply with the provisions of the Indenture, or shall default in the performance or observance of any of the other covenants, agreements or conditions on its part contained in the General Indenture or in any Supplemental Indenture or the Bonds, other than those described in paragraph (a) or (b) above, and such failure, refusal or default shall continue for a period of 45 days after written notice thereof has been delivered to MHESO and the Credit Provider, if any, by the Trustee or by the Owners of not less than 25% in principal amount of the Outstanding Bonds with the consent of the Credit Provider; or
- (d) with respect to any Series of Bonds, any Event of Default pursuant to the Supplemental Indenture authorizing such Series shall occur; or
- (e) (i) except for each Series of Bonds that are secured by a Credit Facility which is an insurance policy, with respect to any Series of Bonds secured by a Credit Facility or Liquidity Facility, the related Credit Provider or Liquidity Provider shall deliver written notice to the Trustee to the effect that MHESO has failed to reimburse or otherwise pay such Credit Provider or Liquidity Provider pursuant to the terms of its Reimbursement Agreement or Credit Provider Agreement as and when such reimbursement or payment becomes due and payable, and pursuant to the terms of the applicable Reimbursement Agreement or Credit Provider Agreement, it is requiring that such Bonds be accelerated, or (ii) for a Series of Bonds secured by a Credit Facility that is an insurance policy, the Credit Provider can deliver written notice to the Trustee that it is requiring that such Bonds be accelerated pursuant to the terms of the Indenture.

*Remedies.* (a) Upon the occurrence and continuance of any Event of Default specified in paragraphs (a), (b) or (e) of Section 10.1 of the General Indenture, the Trustee shall promptly notify MHESO, any Credit Provider, any Liquidity Provider, any counterparty to an Interest Rate Exchange Agreement and each Indenture Agent of the existence of such Event of Default and shall proceed with the consent of the Credit Provider or at the direction of the Credit Provider subject to the provisions of Article XI of the General Indenture, or upon the occurrence and

continuance of any Event of Default specified in paragraphs (c) or (d) of Section 10.1 of the General Indenture, the Trustee shall promptly notify MHESO, any Credit Provider, any Liquidity Provider, and any counterparty to an Interest Rate Exchange Agreement and each Indenture Agent of the existence of such Event of Default and may (or, if instructed by the Owners as described in Section 10.5 of the General Indenture, shall) proceed in its own name, but only with the consent of the Credit Provider or at the direction of the Credit Provider subject to the provisions of Article XI of the General Indenture, to protect and enforce the rights of the Owners and the Credit Provider, if any, by such of the following remedies, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce such rights:

(i) by mandamus or other suit, action or proceeding at law or in equity, to enforce all rights of the Owners, including the right to require MHESO to carry out the covenants and agreements as to, and the assignment of, the Student Loans and to require MHESO to carry out any other covenants or agreements with Owners and to perform its duties as prescribed by law;

(ii) by bringing suit upon the Bonds;

(iii) by action or suit in equity, to require MHESO to account as if it were the trustee of an express trust for the Owners of the Bonds;

(iv) by action or suit in equity to enjoin any acts or things which may be unlawful or in violation of the rights of the Owners of the Bonds; or

(v) upon the occurrence of an Event of Default specified in paragraphs (a) or (b) or (e) of Section 10.1 of the General Indenture; the Trustee shall with the consent or the direction of the Credit Provider, if such Event of Default occurs with respect to the most senior Class of Bonds then Outstanding, and in the case of a Event of Default specified in (c) or (d), the Trustee may with the consent or the direction of the Credit Provider, upon the written direction of the Owners, as provided in Section 10.5 of the General Indenture, after written notice to MHESO and consent of the Credit Provider, to the extent required by law, declare the principal of the most senior Class of the Bonds then Outstanding to be immediately due and payable, whereupon the principal and the accrued interest on such Bonds through the date of acceleration shall, without further action, become and be immediately due and payable, anything in the Indenture, or in the Bonds to the contrary notwithstanding. If all defaults shall be cured, then, the Trustee may annul such declaration and its consequences; provided each Credit Facility or Liquidity Facility for the Bonds previously in effect is fully reinstated and in full force and effect.

(b) If Bonds secured by a Credit Facility are accelerated upon Credit Provider direction or consent, the Trustee shall make a drawing or claim on the Credit Facility concurrently with such acceleration for the principal and accrued interest on such Bonds then due. Such drawing shall be made notwithstanding any right of the Credit Provider to control remedies provided in Section 10.5 of the General Indenture, and the Trustee shall not require any indemnity for making such drawing.

(c) In the enforcement of any rights and remedies under the Indenture, the Trustee shall be entitled to sue for, enforce payment of and receive any and all amounts then or during any default becoming, and at any time remaining, due and unpaid from MHESO for principal, interest or otherwise, under any provisions of the General Indenture or a Supplemental Indenture or of the Bonds, with interest on overdue payments at the rate of interest specified in such Bonds, together with any and all costs and expenses of collection and of all proceedings thereunder and under such Bonds without prejudice to any other right or remedy of the Trustee or of the Owners, and to recover and enforce a judgment or decree against MHESO for any portion of such amounts remaining unpaid, with interest, costs and expenses (including without limitation pretrial, trial and appellate attorney fees), and to collect from MHESO any moneys adjudged or decreed to be payable, provided, however, any recovery against MHESO is limited to the Trust Estate.

(d) Upon the occurrence of any Event of Default, and on the filing of suit or other commencement of judicial proceedings to enforce the rights of the Owners under the Indenture, the Trustee shall be entitled, as a matter of right, to the appointment of a receiver or receivers of the Revenues and of the assets of MHESO relating to the Student Loan Program, pending such proceedings, with such powers as the court making such appointment shall confer.

(e) Except upon the occurrence, and during the continuance of an Event of Default under the Indenture, MHESO hereby expressly reserves and retains the privilege to receive and, subject to the terms and provisions of the Indenture, to keep or dispose of, claim, bring suit upon or otherwise exercise, enforce or realize upon its rights and interest in and to the Student Loans and the proceeds of any collections therefrom, and neither the Trustee nor any Owner shall in any manner be or be deemed to be an indispensable party to the exercise of any such privilege, claim or suit.

(f) The Trustee shall select and liquidate or sell Trust Estate assets as provided in the following paragraph or as provided in the last paragraph of Section 10.2 of the General Indenture but only at the direction of the Credit Provider, and shall not be liable to any Owner, Credit Provider, Liquidity Provider or MHESO by reason of such selection, liquidation or sale.

Whenever moneys are to be applied pursuant to Article X of the General Indenture irrespective of and whether other remedies authorized under the Indenture shall have been pursued in whole or in part, the Trustee may cause any or all of the assets of the Trust Estate to be sold. The Trustee may so sell the assets of the Trust Estate and all right, title, interest, claim and demand thereto and the right of redemption thereof; in one or more parts, at any such place or places, and at such time or times and upon such notice and terms as the Trustee may deem appropriate with Credit Provider consent or at Credit Provider direction and as may be required by law and apply the proceeds thereof in accordance with the provisions of Section 10.2 of the General Indenture at the direction of the Credit Provider or with Credit Provider consent. Upon such sale, the Trustee, with Credit Provider consent or at Credit Provider direction, may make and deliver to the purchaser or purchasers a good and sufficient assignment or conveyance for the same, which sale shall be a perpetual bar both at law and in equity against MHESO, each Credit Provider, each Liquidity Provider, the Owners, and all other persons claiming such properties. No purchaser at any sale shall be bound to see to the application of the purchase money proceeds thereof or to inquire as to the authorization, necessity, expediency or regularity of any such sale. Nevertheless, if so requested by the Trustee, MHESO shall ratify and confirm any sale or sales by executing and delivering to the Trustee or to such purchaser or purchasers all such instruments as may be necessary or, in the judgment of the Trustee, proper for the purpose which may be designated in such request.

To the extent that funds are not otherwise available to pay amounts due to a Credit Provider or to a Liquidity Provider under its Reimbursement Agreement, and unless otherwise provided in a Supplemental Indenture, the Trustee, at the request and at the sole direction of the Credit Provider (except as provided in the final paragraph of Section 10.2 of the General Indenture), shall convey or sell and deliver Student Loans purchased with assets of the Trust Estate to the Credit Provider or Liquidity Provider in partial or complete satisfaction of such obligations of MHESO, subject to the acceptance of such Student Loans by the Credit Provider or Liquidity Provider at a purchase price equal to the principal outstanding plus accrued interest. The Trustee will immediately notify persons or entities claiming in writing to be beneficial owners of Bonds upon learning of the occurrence of an Event of Default, or event leading to an Event of Default with the passage of time or the giving of notice. The latter consists of events that have occurred but are not yet an Event of Default because of a time delay (cure period) specified in the Indenture. Should an event of default under the Reimbursement Agreement have occurred and be continuing unremedied for more than 15 days the Credit Provider under such Reimbursement Agreement shall be entitled to direct the Trustee to sell Student Loans constituting part of the Trust Estate and to apply the proceeds thereof as provided in Section 10.3 of the General Indenture.

*Priority of Payments After Default.* (a) In the event that, upon the occurrence and during the continuance of any Event of Default, the funds held by the Trustee and Paying Agents shall be insufficient for the payment of principal or Redemption Price of and interest then due on the Bonds, such funds (other than funds held for the payment of particular Bonds pursuant to Article XII of the General Indenture or which have theretofore become due at maturity) and any other amounts received or collected by the Trustee acting pursuant to Article X of the General Indenture, after providing for the payment of any expenses necessary in the opinion of the Trustee to protect the interest of the Owners of the Bonds and the Credit Provider and for the payment of the fees, charges and expenses and liabilities incurred and advances made by the Trustee or another Indenture Agent in the performance of their respective duties under the General Indenture (except that no lien shall attach to the proceeds of any drawing under a Credit Facility or Liquidity Facility or on any remarketing proceeds for the payment of such fees, charges and expenses), shall be applied as follows: (i) Unless the principal of all of the Bonds shall have become or have been declared due and payable:

FIRST: To the payment to the persons entitled thereto of all installments of interest then due on Class I Bonds and unpaid installments of amounts due on any Class I Interest Rate Exchange Agreements in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment, then to the payment thereof ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference.

SECOND: To the payment to the persons entitled thereto of the unpaid principal or Redemption Price of any Class I Bonds which shall have become due and, if the amounts available shall not be sufficient to pay in full all the Class I Bonds due, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

THIRD: To the payment of any amounts then due and owing on a Credit Facility or Liquidity Facility for Class I Bonds not paid pursuant to Section 10.3(a)(iv) of the General Indenture.

FOURTH: To the payment to the persons entitled thereto of all installments of interest then due on Class II Bonds and unpaid installments of amounts due on any Class II Interest Rate Exchange Agreements in the order of the maturity of such installments, and if the amount available shall not be sufficient to pay in full any installment, then to the payment thereof ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference.

FIFTH: To the payment to the persons entitled thereto of the unpaid principal or Redemption Price of any Class II Bonds which shall have become due and, if the amounts available shall not be sufficient to pay in full all the Class II Bonds due, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

SIXTH: To the payment of any amounts then due and owing on a Credit Facility or Liquidity Facility for Class II Bonds not paid pursuant to Section 10.3(a)(iv) of the General Indenture.

SEVENTH: To the payment to the persons entitled thereto of all installments of interest then due on Class III Bonds and unpaid installments of amounts on any Class III Interest Rate Exchange Agreements in the order of maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment, then to the payment thereof ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference.

EIGHTH: To the payment to the persons entitled thereto of the unpaid principal or Redemption Price of any Class III Bonds which shall have become due and, if the amounts available shall not be sufficient to pay in full all the Class III Bonds due, then to the payment thereof ratably, according to the amounts of the principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

NINTH: To the payment of any amounts then due and owing on a Credit Facility or Liquidity Facility for Class III Bonds not paid pursuant to Section 10.3(a)(iv) of the General Indenture.

TENTH: To the payment to the persons entitled thereto of all installments of interest then due on Class IV Bonds and unpaid installments of amounts on any Class IV Interest Rate Exchange Agreements in the order of the maturity of such installments, and if the amount available shall not be sufficient to pay in full any installment, then to the payment thereof ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference.

ELEVENTH: To the payment to the persons entitled thereto of the unpaid principal or Redemption Price of any Class IV Bonds which shall have become due and, if the amounts available shall not be sufficient to pay in full all the Class IV Bonds due, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

TWELFTH: To the payment of any amounts then due and owing on a Credit Facility or Liquidity Facility for Class IV Bonds not paid pursuant to Section 10.3(a)(iv) of the General Indenture.

THIRTEENTH: With respect to Bonds and Interest Rate Exchange Agreements By Class in Descending Priority, commencing with Class V; to the payment to the persons entitled thereto of all installments of interest and installments of amounts on any Interest Rate Exchange Agreement then due in order of the maturity of such installments (and if the amount available shall not be sufficient to pay in full any installment, then to the payment thereof ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference) and then to the payment of the unpaid principal or Redemption Price which shall have become due and, if the amounts available shall not be sufficient to pay such principal or Redemption Price in full, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

(ii) If the principal of all of the Bonds have become or have been declared due and payable, first to the payment of the principal and interest then due and unpaid upon the Class I Bonds and payments on Class I Interest Rate Exchange Agreements without preference of priority of principal over interest or of interest over principal, or of any installment of interest or Interest Rate Exchange Agreement amounts over any other installment of interest, or of any Class I Bonds or Class I Interest Rate Exchange Agreements over any other Class I Bond or Class I Interest Rate Exchange Agreements, ratably, according to the amounts due respectively for principal and interest, to the persons entitled thereto without any discrimination or preference except as to any difference in the respective rates of interest specified in the Class I Bonds or Class I Interest Rate Exchange Agreements; second, to the payment of any amounts then due and owing on a Credit Facility or Liquidity Facility for Class I Bonds not paid pursuant to Section 10.3(a)(iv) of the General Indenture; third, to the payment of principal and interest then unpaid on any Class II Bonds and payments on Class II Interest Rate Exchange Agreements, without preference of priority of principal over interest or Interest Rate Exchange Agreement amounts over principal and interest, ratably, according to the amounts due to the persons entitled thereto without any discrimination or preference; fourth, to the payment of any amounts then due and owing on a Credit Facility or Liquidity Facility for Class II Bonds not paid pursuant to Section 10.3(a)(iv) of the General Indenture, and finally, to the payment of the principal and interest then due and unpaid upon the remaining Bonds and Interest Rate Exchange Agreements by Class in Descending Priority without preference or priority of principal over interest or Interest Rate Exchange Agreement amounts or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond or Interest Rate Exchange Agreement amounts of one Class over any other Bond or Interest Rate Exchange Agreement amounts of that same Class, ratably, according to the amounts due respectively for principal and interest and Interest Rate Exchange Agreement amounts, to the persons entitled thereto without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds and Interest Rate Exchange Agreements within a Class; provided a Credit Provider or Liquidity Facility for a Class of Bonds shall be paid all amounts due and owing to it prior to any payment on Bonds subordinate to the Bonds secured by such Credit Facility or Liquidity Facility.

(iii) If the principal of all the Bonds shall have been declared immediately due and payable, and if such declarations shall thereafter have been rescinded and annulled under the provisions of Article X of the General Indenture, then, subject to the provisions of Section 10.2(a)(v) of the General Indenture in the event that the principal of all the Bonds shall later become due or be declared due and payable, the moneys shall be applied in accordance with the provisions of Section 10.3(a)(i) of the General Indenture.

(iv) With respect to any payment made under Section 10.3(a) of the General Indenture, in the event the Bonds on which a payment is to be made are secured by a Credit Facility, payment of principal and interest on such Bonds shall be paid from a drawing on the Credit Facility as set forth in Section 5.5 of the General Indenture and the Credit Provider shall be reimbursed for the drawing in the priority given to such Bonds in Subsections (i) and (ii) above.

(b) Whenever moneys are to be applied by the Trustee pursuant to the provisions of Section 10.3 of the General Indenture, such moneys shall be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional money becoming available for such application in the future. The deposit of such moneys with the Paying Agents, or otherwise setting aside such moneys in trust for the proper purpose, shall constitute proper application by the Trustee, and the Trustee shall incur no liability whatsoever to MHESO, to any Owner or to any other person for any delay in applying any such moneys, so long as the Trustee acts with reasonable diligence, having due regard for the circumstances, and ultimately applies the same in accordance with such provisions of the General Indenture as may be applicable at the time of application by the Trustee. Whenever the

Trustee shall exercise such discretion in applying such moneys, it shall fix the date (which shall be an Interest Payment Date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee shall give such notice as it may deem appropriate for the fixing of any such date. The Trustee shall not be required to make payment to the Owner of any unpaid Bond unless such Bond shall be presented to the Trustee for appropriate endorsement or for cancellation if fully paid.

*Termination of Proceedings.* In case any proceedings taken by the Trustee on account of any Event of Default shall have been discontinued or abandoned for any reason with the consent of the Credit Provider, then in every such case MHESO, the Trustee and the Owners shall be restored to their former positions and rights, respectively, and all rights, remedies, powers and duties of the Trustee shall continue as though no such proceeding had been taken; provided each Credit Facility or Liquidity Facility for the Bonds previously in effect is fully reinstated and in full force and effect.

*Owners' Direction of Proceedings.* Whenever it is provided that the Owners of the Bonds shall enjoy certain rights, be permitted to exercise certain remedies or to direct the Trustee to take certain actions, Section 10.5 of the General Indenture shall control. Upon the occurrence of an Event of Default described in Section 10.1(c) or (d) of the General Indenture, the Credit Provider or the Owners of not less than 100% in principal amount of the Bonds of the most senior Class then Outstanding with the consent of the Credit Provider, or, upon the occurrence of an Event of Default described in Section 10.1(a), (b) or (e) of the General Indenture, the Credit Provider or the Owners of a majority in the principal amount of the Bonds of the most senior Class then Outstanding with the consent of the Credit Provider, shall have the right to direct the Trustee to take all or any of the actions described in Section 10.2(a) of the General Indenture. In the event that such Credit Provider or the Owners with the consent of the Credit Provider have previously given to the Trustee notice of an Event of Default and shall have afforded the Trustee a reasonable opportunity, following the offer to the Trustee of security and indemnity satisfactory to it against the fees, costs, expenses and liabilities to be incurred therein or thereby, either to proceed to exercise the powers granted or to pursue a remedy described herein, and the Trustee shall have refused or neglected to comply with such request, then the Credit Provider or the Owners with the consent of the Credit Provider of the requisite percentage in principal amount of the Bonds of the most senior Class then Outstanding with the consent of the Credit Provider may exercise such rights.

In the event that a Credit Provider has issued a Credit Facility or a Liquidity Provider has issued a Liquidity Facility respecting all of a Series of Bonds or Class within that Series of Bonds and unless the Credit Provider or Liquidity Provider is then in receivership, bankruptcy or reorganization or is then continuing wrongfully to dishonor drawings under the Credit Facility or Liquidity Facility, upon the occurrence of any Event of Default or any other event described below, the Credit Provider or, in the event there is no Credit Provider, the Liquidity Provider (provided amounts are owing to the Liquidity Provider under the applicable Reimbursement Agreement) shall be considered as the Owner of 100% of such Series of Bonds or Class within that Series of Bonds solely for the purpose of directing the actions of the Trustee under Article X of the General Indenture. All rights and remedies described in Article X of the General Indenture shall apply not only following the occurrence of an Event of Default, but also following the occurrence of any event which gives rights to a Credit Provider or Liquidity Provider upon the occurrence of an event of default under the Reimbursement Agreement with that Credit Provider or Liquidity Provider. Notwithstanding anything else in the Indenture, if the Trustee receives contrary direction from the Owners, the Credit Provider, and the Liquidity Provider for the same Class or Series of Bonds, it shall act on the direction of the Credit Provider provided (1) the direction complies with the requirements of the Indenture (including the provisions of satisfactory indemnity), and (2) the Credit Provider is not then in receivership, bankruptcy or reorganization or continuing to dishonor wrongfully a drawing on the Credit Facility. If the conditions for direction by the Credit Provider are not met, the Trustee shall act on the direction of the Liquidity Provider provided (1) the direction complies with the requirements of the Indenture (including the provisions of satisfactory indemnity), (2) the Liquidity Provider is not then in receivership, bankruptcy or reorganization or continuing to dishonor wrongfully a drawing on the Liquidity Facility, and (3) amounts are owing to the Liquidity Provider under the applicable Reimbursement Agreement. If the conditions for direction by the Credit Provider and Liquidity Provider are not met, the Trustee shall act on the direction of the Owners, provided the direction complies with the requirements of the Indenture.

### *Limitation on Rights of Bondholders.*

(a) Except as otherwise specifically provided by Section 10.5 or Section 10.6 of the General Indenture, no Owner of any Bond shall have any right to institute any suit, action, mandamus or other proceeding in equity or at law under the Indenture, or for the protection or enforcement of any right under the Indenture. It is understood and intended that, except as otherwise above provided, no one or more Owners of the Bonds shall have any right in any manner whatever by its or their action to affect, disturb or prejudice the security of the Indenture, or to enforce any right under the Indenture with respect to the Bonds or the Indenture, except in the manner provided in the Indenture, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner provided and for the benefit of Owners of the Outstanding Bonds.

(b) Each Owner of any Bond by acceptance thereof shall be deemed to have agreed that any court in its discretion may require, in any suit for the enforcement of any right or remedy under the General Indenture or any Supplemental Indenture, or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the reasonable costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable pretrial, trial and appellate attorneys' fees, against any party litigant in any such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but these provisions shall not apply to any suit instituted by the Trustee.

### **Concerning the Indenture Agents**

*Appointment and Acceptance of Duties of Trustee.* By executing the Indenture, the Trustee accepts the trusts and obligations imposed upon it by the Indenture and agrees to perform such trusts and obligations, but only upon and subject to the following express terms and conditions:

(a) The Trustee, prior to the occurrence of an Event of Default and after the curing of all Events of Default which may have occurred, undertakes to perform such duties and only such duties as are specifically set forth in the General Indenture and there shall be no implied duties or obligations. In case an Event of Default has occurred (which has not been cured or waived) the Trustee shall exercise such of the rights and powers vested in it by the General Indenture, and use the same degree of care and skill in their exercise, as a prudent man would exercise or use in the circumstances in the conduct of his own affairs.

(b) The Trustee may execute any of the trusts or powers of the Indenture and perform any of its duties by or through attorneys, agents, receivers or employees but shall be answerable for the conduct of the same in accordance with the standard specified above, and shall be entitled to act, upon the opinion or advice of its counsel concerning all matters of the Indenture, and may in all cases be reimbursed for reasonable compensation paid to all such attorneys, agents, receivers and employees as may reasonably be employed in connection with the trust hereof. The Trustee may act upon an Opinion of Counsel, including Bond Counsel, and shall not be responsible for any loss or damage resulting from any action by it taken or omitted to be taken in good faith in reliance upon such Opinion of Counsel. The Trustee may act upon a Issuer Order and shall not be responsible for any loss or damage resulting from any action by it taken or omitted to be taken in good faith in reliance upon such Issuer Order without negligence or willful default. The Trustee need not investigate or make any independent determination of the facts, representations or conclusions contained in a Issuer Order. Prior to taking any action under the Indenture, the Trustee shall be entitled to a Issuer Order and/or an Opinion of Counsel that all conditions precedent under the General Indenture and any Supplemental Indenture to the taking of such action have been satisfied.

(c) The Trustee shall be protected in acting upon any notice, request, consent, certificate, order, affidavit, letter, telegram or other paper or document reasonably believed by it to be genuine and correct and to have been signed or sent by the proper person or persons. Any action taken by the Trustee pursuant to the Indenture upon the request or authority or consent of any person who at the time of making such request or giving such authority or consent is the registered Owner of any Bond shall be conclusive and binding upon all future Owners of the same Bond and upon Bonds issued in exchange therefor or in place thereof.

(d) The Trustee shall not be accountable or responsible in any manner whatsoever for any action of MHESO, any other Indenture Agent, the Servicer or Subservicer, any remarketing agent or for the application of moneys by any Servicer or Subservicer until such time as funds are received by the Trustee.

(e) In fulfilling its responsibilities under the Indenture, under any other instruments or agreements, or under law the Trustee may act in full reliance upon MHESO or any Servicer or Subservicer with respect to all such determinations made, actions taken and directions to the Trustee given by them, and the Trustee shall have no duty or responsibility to MHESO, the Servicer, the Subservicer, the Owners of the Bonds or any other person or entity for any action (or inaction) of the Trustee taken in reliance upon any such determinations, actions or directions. MHESO shall hold the Trustee harmless for any error or omission resulting from the Trustee's reliance upon MHESO, the Indenture or any Servicer unless in connection with such action or omission the Trustee has unreasonably or negligently failed to perform its obligations under an agreement with any Servicer or under the Indenture.

*Resignation of Trustee.* The Trustee may at any time resign and be discharged of the duties and obligations created by the Indenture by giving not less than sixty (60) days' written notice to MHESO and each Credit Provider, and mailing notice thereof specifying the date when such resignation shall take effect, to the registered Owners, and such resignation shall take effect upon the day specified in such notice unless previously a successor shall have been appointed, as provided in Section 11.9 of the General Indenture, in which event such resignation shall take effect immediately on the appointment of such successor. Notwithstanding the foregoing, no resignation of the Trustee under the Indenture shall become effective until a successor Trustee has been appointed and accepted its appointment and each Credit Facility and Liquidity Facility has been properly transferred to the successor Trustee in accordance with their respective terms.

*Removal of Trustee.* The Trustee shall be removed by MHESO if at any time so requested by an instrument or concurrent instruments in writing, filed with the Trustee and MHESO and signed by the Owners of a majority in principal amount of the Bonds then Outstanding or their attorney-in-fact duly authorized, excluding any Bonds held by or for the account of MHESO, provided that consent of the Credit Provider shall have been obtained. MHESO may remove the Trustee at any time, except during the existence of an Event of Default, for such cause as shall be determined in the sole discretion of MHESO by filing with the Trustee an instrument signed by an Authorized Representative and consent of the Credit Provider. MHESO shall remove the Trustee if directed to do so by a Credit Provider providing a Credit Facility for the most senior Class of Bonds which has such right pursuant to the applicable Reimbursement Agreement, by filing with the Trustee an instrument signed by an Authorized Representative and the Credit Provider. Notwithstanding the foregoing, no removal of the Trustee shall become effective until a successor has been appointed and has accepted such appointment and until each Credit Facility and Liquidity Facility then in effect has been properly transferred to a successor Trustee in accordance with their respective terms.

*Appointment of Successor Trustee.*

(a) If at any time the Trustee shall resign or shall be removed or shall become incapable of acting, or shall be adjudged bankrupt or insolvent, or if a receiver, liquidator or conservator of the Trustee, or of its property, shall be appointed, or if any public officer shall take charge or control of the Trustee, or of its property or affairs, MHESO covenants and agrees that it will promptly thereupon appoint a successor Trustee. MHESO shall mail notice of any such appointment made by it within 20 days after such appointment to all Owners of Bonds.

(b) If no appointment of a successor Trustee shall have been made pursuant to the provisions of subsection (a) above within 45 days after the Trustee shall have given to MHESO written notice, or after a vacancy in the office of the Trustee shall have occurred by reason of its inability to act, the Trustee or the Owner of any Bond may apply to any court of competent jurisdiction to appoint a successor Trustee. Said court may thereupon, after such notice, if any, as such court may deem proper and prescribe, appoint a successor Trustee.

Defeasance; Miscellaneous Provisions

*Defeasance.* (a) If MHESO shall pay or cause to be paid to the Owners of the Bonds, the principal or Redemption Price and interest to become due thereon at the times and in the manner stipulated in the Bonds and in the Indenture, and pay or cause to be paid (i) all Rebate Amounts and Excess Interest required to be paid for the U.S.



Treasury, (ii) to each Indenture Agent its fees, costs and expenses, (iii) to each Credit Provider and Liquidity Provider all amounts owing under each Credit Facility or Liquidity Facility or Reimbursement Agreement relating thereto, (iv) to each remarketing agent all amounts owing under each remarketing agreement, and (v) to each party to any Interest Rate Exchange Agreement all amounts owing to it, then the pledge of the Trust Estate, including any Revenues and other moneys, securities, funds and property pledged and all other rights granted shall be discharged and satisfied. In such event, the Trustee shall, upon the request of MHESO, execute and deliver to MHESO all such instruments as may be desirable to evidence such discharge and satisfaction and the Indenture Agents shall pay over or deliver to MHESO all moneys or securities held by them pursuant to the Indenture which are not required for the payment of Bonds not theretofore surrendered for such payment. MHESO shall also provide (i) an accountant's verification and (ii) an opinion of Bond Counsel addressed to the Credit Provider.

(b) Except as otherwise provided in any Supplemental Indenture, all Bonds shall, prior to the maturity or Redemption Date thereof, be deemed to have been paid and no longer Outstanding if (i) in case any of said Bonds are to be redeemed on any date prior to their maturity, MHESO shall have given to the Trustee in form satisfactory to it irrevocable instructions to mail as provided in Article VI of the General Indenture notice of redemption on said date of such Bonds, (ii) there shall have been deposited with the Trustee either moneys in an amount which shall be sufficient, or noncallable and nonprepayable Governmental Obligations (including any Governmental Obligations issued or held in book entry form on the books of the Department of the Treasury of the United States of America) the principal of and the interest on which when due, without reinvestment, will provide moneys which together with the moneys, if any, deposited with the Trustee at the same time, shall be sufficient to pay when due the principal of and interest to become due on such Bonds on and prior to the Redemption Date or maturity date thereof, as the case may be, verified as to sufficiency by a report of an Accountant, and (iii) in the event said Bonds are not by their terms subject to redemption within the next succeeding 60 days, MHESO shall have given the Trustee in form satisfactory to it irrevocable instructions to mail, as soon as practicable, a notice to the Owners of such Bonds that the deposit required by (ii) above has been made with the Trustee and that said Bonds are deemed to have been paid in accordance with Section 12.1 of the General Indenture and stating such maturity or Redemption Date upon which moneys are to be available for the payment of the principal or Redemption Price, if any, on said Bonds. Neither Governmental Obligations or moneys deposited with the Trustee pursuant to Section 12.1 of the General Indenture nor principal or interest payments on any such Governmental Obligations shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal of or Redemption Price, if any, and interest on said Bonds; but any cash received from such principal or interest payments on such Governmental Obligations deposited with the Trustee, if not then needed for such purpose; shall, to the extent practicable, be reinvested in Governmental Obligations maturing at times and in amounts sufficient to pay when due the principal or Redemption Price, if any, and interest to become due on said Bonds on and prior to such maturity date thereof, as the case may be, and interest earned from such reinvestments shall, as contemplated by a report of an Accountant verifying continued sufficiency, be paid over to MHESO, as received by the Trustee, free and clear of any trust, lien or pledge; provided, however, that such reinvestment may be effected only upon receipt by the Trustee of a Favorable Opinion.

(c) Except as otherwise provided in any Supplemental Indenture, all Bonds shall, prior to the Redemption Date thereof, be deemed to have been paid and no longer Outstanding if (i) the Credit Facility with respect to such Bonds remains in effect through the Redemption Date, (ii) MHESO has given notice of redemption of the Bonds, which redemption shall take place no later than 45 days from the date the Bonds are deemed to have been paid, and (iii) there shall have been deposited with the Trustee moneys in an amount which, when added to the other moneys in the Indenture certified to be available by MHESO, is certified by MHESO to be sufficient to pay the principal and interest on the Bonds to the Redemption Date. In the event the Bonds are Adjustable Rate Bonds, for periods in which the interest rate has not been determined, a rate equal to the maximum rate such Bonds may bear shall be assumed. The Trustee shall deposit the moneys to be set aside for payment of the Redemption Price of the Bonds in a separate redemption account or pursuant to a separate escrow agreement, if MHESO so designates, and shall use the money for the purpose of reimbursing the Credit Provider for a drawing on the Credit Facility. The money shall be invested only in non-callable and non-prepayable Governmental Obligations which mature prior to the Redemption Date.

The Trustee shall not terminate the Credit Facility or release the money in the redemption account until the Bonds have been redeemed in full with either a drawing on the Credit Facility or, if there is a failure to pay under the Credit Facility, the moneys in the redemption account.

(d) The deposit required by paragraphs (b) or (c) above may be made with respect to any Series or Class of Bonds, or a portion thereof, within any particular maturity, in which case such maturity of Bonds shall no longer be deemed

to be Outstanding under the terms of the Indenture, and the Owners of such defeased Bonds shall be secured only by such trust funds and not by any other part of the Trust Estate, and the Indenture shall remain in full force and effect to protect the interests of the Owners of Bonds remaining Outstanding thereafter.

(e) Bonds or interest installments for the payment of which moneys shall have been set aside and shall be held in trust by the Indenture Agents (through deposit by MHESO of funds for such payment or otherwise) shall, upon maturity or upon the Redemption Date established therefor, be deemed to have been paid and no longer Outstanding. Should any of the Bonds not be presented for payment when due, the Trustee shall retain from any moneys transferred to it for the purpose of paying said Bonds so due, for the benefit of the Owners thereof, a sum of money sufficient to pay such Bonds when the same are presented by the Owners thereof for payment (upon which sum the Trustee shall not be required to pay interest). All liability of MHESO to the Owners of such Bonds and all rights of such Owners against MHESO under the Bonds or under the Indenture shall thereupon be and become limited to amounts on deposit with the Trustee and set aside for such payment, and the sole right of such Owners shall thereafter be against such deposit. The Trustee shall bear no duty or liability to the Owners of such nonpresented Bonds other than to disburse funds from such deposit upon presentation of the appropriate Bond. If any Bond shall not be presented for payment within the period of six years following its maturity, the Trustee shall, to the extent permitted by law, turn over the money theretofore held by it for payment of such Bond to MHESO, provided, however, that such amounts shall not be so transferred until at least one year after the final maturity date of the Bonds of the related Series.

*Nonliability of Officers.* It is expressly a condition of the General Indenture that any agreements, covenants or representations contained in the General Indenture or contained in the Bonds do not and shall never constitute or give rise to a personal or pecuniary liability or charge against the officers, employees, agents or members of MHESO, or the general credit of MHESO, and in the event of a breach of any such agreement, covenant or representation, no personal or pecuniary liability or charge payable directly or indirectly from the general revenues of MHESO shall arise therefrom.

## **THE SIXTH AND SEVENTH SUPPLEMENTAL INDENTURES**

The following is a summary or extract of certain provisions of the Sixth Supplemental Indenture and Seventh Supplemental Indenture. Such summary or extract does not purport to be complete and is subject to change prior to delivery of the 2004 Series Bonds. References are to Sections of the Sixth Supplemental Indenture or Seventh Supplemental Indenture unless otherwise noted.

The Sixth Supplemental Indenture and the Seventh Supplemental Indenture, each dated as of July 1, 2004, are entered into by and between MHESO and the Trustee and supplement the General Indenture, dated as of November 1, 1999, between MHESO and the Trustee.

### **Short Title, Definitions and Authority**

*Definition of Investment Securities.* As permitted by the definition of Investment Securities in Section 1.1 of the General Indenture, the definition of Investment Securities is amended by the Sixth Supplemental Indenture and Seventh Supplemental Indenture to read as follows:

“Investment Securities” means (to the extent permitted by State Law for the investment of funds by MHESO) the following categories of securities:

A. Direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury, and CATS and TIGRS) or obligations the principal of and interest on which are unconditionally guaranteed by the United States of America.

B. Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following federal agencies and provided such obligations are, backed by the full faith and credit of the United States of America (stripped securities are only permitted if they have been stripped by the agency itself:

- (a) U.S. Export-Import Bank (Eximbank)  
Direct obligations or fully guaranteed certificates of beneficial ownership
- (b) Farmers Home Administration (FmHA)  
Certificates of beneficial ownership
- (c) Federal Financing Bank
- (d) Federal Housing Administration Debentures (FHA)  
General Services Administration Participation certificates
- (f) Government National Mortgage Association (GNMA or "Ginnie Mae")  
GNMA - guaranteed mortgage-backed bonds  
GNMA - guaranteed pass-through obligations
- (g) U.S. Maritime Administration  
Guaranteed Title XI financing
- (h) U.S. Department of Housing and Urban Development (HUD)  
Project Notes  
Local Authority Bonds  
New Communities Debentures - U.S. government guaranteed debentures  
U.S. Public Housing Notes and Bonds - U.S. government guaranteed public housing notes and bonds

C. Bonds, debentures, notes other evidence of indebtedness issued or guaranteed by any of the following non-full faith and credit U.S. government agencies and having a rating of "Aaa" by Moody's (stripped securities are only permitted if they have been stripped by the agency itself):

- (a) Federal Home Loan Bank System  
Senior debt obligations
- (b) Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac")  
Participation Certificates  
Senior debt obligations
- (c) Federal National Mortgage Association ("FNMA" or "Fannie Mae")  
Mortgage-backed securities and senior debt obligations
- (d) Student Loan Marketing Association ("SLMA" or "Sallie Mae")  
Senior debt obligations
- (e) Resolution Funding Corp. ("REFCORP") obligations
- (f) Farm Credit System  
Consolidated system-wide bonds and notes

D. Money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of "AAA-m-G"; "AAA-m"; or "AA-m" and if rated by Moody's rated "Aaa" and if rated by Fitch rated "AAA/V1+" or "AA/V1+."

E. Certificates of deposit secured at all times by collateral described in (A) and/or (B) above. Such certificates must be issued by commercial banks, savings and loan associations or mutual savings banks. The collateral must be held by a third party and the bondholders must have a perfected first security interest in the collateral.

F. Certificates of deposit, savings accounts, deposit accounts or money market deposits which fully insured by FDIC.

G. Investment agreements, including guaranteed investment contracts, forward purchase agreements and reserve fund put agreements acceptable to the Credit Provider and the Rating Agency.

H. Commercial paper rated, at the time of purchase, "Prime - 1" by Moody's and "A-1" or better by S&P and if rated by Fitch "F-1+".

I. Bonds or notes issued by any state or municipality which are rated by Moody's and S&P and, if rated by Fitch in one of its two highest rating categories, in one of the two highest rating categories assigned by such agencies.

J. Federal funds or bankers acceptances with a maximum term of one year of any bank which has an unsecured, uninsured and unguaranteed obligation rating of "Prime - 1" or "Aaa" or better by Moody's, "A-1" or "A" or better by S&P and if rated by Fitch "F-1" or "A" or better.

K. Repurchase agreements for 30 days or less must follow the following criteria. Repurchase agreements which exceed 30 days must be acceptable to the Credit Provider.

Repurchase agreements are agreements which provide for the transfer of securities from a dealer bank or securities firm (seller/borrower) to a municipal entity (buyer/lender), and the transfer of cash from a municipal entity to the dealer bank or securities firm with an agreement that the dealer bank or securities firm will repay the cash plus a yield to the municipal entity in exchange for the securities at a specified date.

(a) Repurchase agreements must be between the municipal entity and a dealer bank or securities firm, which include primary dealers on the Federal Reserve reporting dealer list which are rated "Prime - 1" or "A2" or above by Moody's, or bank rated "Prime - 1" or "A2" or above by Moody's and if rated by Fitch "A".

(b) The written repurchase agreements must include the following:

a. Securities which are acceptable for transfer are:

(1) Direct U.S. governments or

(2) Federal agencies backed by the full faith and credit of the U.S. government, FNMA and FHLMC

b. The term of the repurchase agreement may be up to 30 days,

c. The collateral must be delivered to the municipal entity, trustee (if trustee is not supplying the collateral) or third-party acting as agent for the trustee (if the trustee is supplying the collateral) before/simultaneous with payment (perfection by possession of certificated securities).

d. Valuation of collateral

(1) The securities must be valued weekly, marked-to-market at current market price plus accrued interest

(a) The value of collateral must be equal to 104% of the amount of cash transferred by the municipal entity to the dealer bank or security firm under the repurchase contract plus accrued interest. If the value of securities held as collateral slips below 104% of the value of the cash transferred by municipality, then additional cash and/or acceptable securities must be transferred. If, however, the securities used as collateral are FNMA or FHLMC, then the value of collateral must equal 105%.

(b) Legal opinion must be delivered to the municipal entity that the repurchase agreement meets guidelines under state law for legal investment of public funds.

#### **Authorization, Terms and Issuance of 2004 Series A Bonds and the 2004 Series B Bonds**

*Principal Amount, Designation and Series.* Pursuant to the provisions of the General Indenture, a Series of Bonds entitled to the benefit, protection and security of the General Indenture are authorized by the Sixth Supplemental Indenture in the aggregate principal amount of \$67,000,000 and shall be designated as and shall be distinguished from the Bonds of all other Series by the title, “Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds, 2004 Series A (Taxable)”. The 2004 Series A Bonds constitute Federally Taxable Bonds and Adjustable Rate Bonds and shall have a Class I designation for purposes of the General Indenture.

Pursuant to the provisions of the General Indenture, a Series of Bonds entitled to the benefit, protection and security of the General Indenture are authorized by the Seventh Supplemental Indenture in the aggregate principal amount of \$88,500,000 and shall be designated as and shall be distinguished from the Bonds of all other Series by the title, “Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds, 2004 Series B (Tax Exempt)”. The 2004 Series B Bonds constitute Adjustable Rate Bonds and shall have a Class I designation for purposes of the General Indenture.

*Purposes of Issuance.* Each series of the 2004 Series Bonds are issued for the purposes of obtaining funds to finance Student Loans, refunding the Series 1992, 1993 and 1994B Bonds, and funding the Debt Service Reserve Requirement.

#### **Deposits into Funds and Accounts; Disposition of Proceeds of the Sale of the 2004 Series Bonds; and Use and Disbursements of Funds**

*Deposits into Funds and Accounts on the Issue Date.* The net proceeds of the sale of the respective series of 2004 Series Bonds will be distributed and applied in accordance with the following provisions:

(a) On the Issue Date, the Trustee shall deposit into the Capitalized Interest Subaccount of the Taxable Account of the Revenue Fund an amount equal to \$-0- from the net proceeds of the 2004 Series A Bonds. On the Issue Date, the Trustee shall deposit into the 2004 Series B Capitalized Interest Subaccount of the 2004 Series B Account of the Revenue Fund an amount equal to \$-0- from the net proceeds of the 2004 Series B Bonds.

(b) On the Issue Date, the Trustee shall deposit into the Taxable Account of the Debt Service Reserve Fund from the net proceeds of the 2004 Series A Bonds an amount equal to \$1,340,000 (which equals the initial Debt Service Reserve Requirement for the 2004 Series A Bonds). On the Issue Date, the Trustee shall deposit into the 2004 Series B Account of the Debt Service Reserve Fund (created under the Seventh Supplemental Indenture) from the net proceeds of the 2004 Series A Bonds an amount equal to \$1,770,000 (which equals the initial Debt Service Reserve Requirement for the 2004 Series B Bonds). On the Issue Date, the Trustee shall deposit into the Taxable Account of the Acquisition Fund an amount equal to \$63,890,000, the remaining net proceeds of the 2004 Series A Bonds.

On the Issue Date, the Trustee shall deposit into the 2004 Series B Capitalized Interest Subaccount of the 2004 Series B Account of the Revenue Fund an amount equal to \$-0- from the net proceeds of the 2004 Series B Bonds. On the Issue Date, the Trustee shall deposit into the 2004 Series B Account of the Acquisition Fund an amount equal to \$20,000,000 from the net proceeds of the 2004 Series B Bonds. On the Issue Date, the Trustee shall deposit into the Redemption Fund established under the Series 1992 Indenture, an amount equal to \$30,000,000 from the net proceeds of the 2004 Series B Bonds for the redemption of the Series 1992 Bonds, upon receipt of a like principal amount of Student Loans previously financed with proceeds of the Series 1992 Bonds; which Student Loans will be deposited in the 2004 Series B Account of the Student Loan Fund. On the Issue Date, the Trustee shall deposit into the Redemption Fund established under the Series 1993 Indenture, an amount equal to \$20,000,000 from the net proceeds of the 2004 Series B Bonds for the redemption of the Series 1993 Bonds, upon receipt of approximately \$18,600,000 principal amount of Student Loans previously financed with proceeds of the Series 1993 Bonds and approximately \$1,400,000 (in

cash and Student Loans) remaining in the Series 1993 Debt Service Reserve Fund; which Student Loans and cash will be deposited in the 2004 Series B Account of the Student Loan Fund and the 2004 Series B Account of the Acquisition Fund, respectively. On the Issue Date, the Trustee shall deposit into the Redemption Fund established under the Series 1994 Indenture, an amount equal to \$18,500,000 from the net proceeds of the 2004 Series B Bonds for the redemption of the Series 1994B Bonds, upon receipt of a like principal amount of Student Loans previously financed with proceeds of the Series 1994B Bonds; which Student Loans will be deposited in the 2004 Series B Account of the Student Loan Fund.

(c) Within forty-five (45) days after the Closing Date, the Trustee shall transfer the amount deposited in the respective Series 2004 Account of the Acquisition Fund to MHESO in exchange for a like aggregate principal amount as of the date of transfer of Student Loans. Such transfers, as well as any subsequent acquisitions of Student Loans by the Trustee under the General Indenture, will be evidenced by an Assignment. All Student Loans so transferred will be deposited to the credit of the Taxable Account and the 2004 Series B Account of the Student Loan Fund, as applicable, and constitute a part of the Trust Estate.

*Payment of Program Expenses.* MHESO shall pay all Program Expenses from any available funds not held under the Indenture, including, without limitation, the Loan Capital Fund of the Issuer. To the extent not so paid, the Trustee shall pay Program Expenses from amounts available therefor in the respective Revenue Fund to the extent provided in Section 5.4 of the General Indenture. If the Issuer fails to pay all Program Expenses from any available funds not held under the Indenture as required hereunder, the Issuer shall notify the Rating Agency of such failure and the Trustee may with the consent of the Credit Provider and shall at the direction of the Credit Provider pursue all available remedies against the Issuer as set forth in Article X of the General Indenture. Notwithstanding the foregoing, Program Expenses to be paid from the related Revenue Fund shall be limited to the amounts shown in the Closing Cash Flow Projection relating to the respective series of 2004 Series Bonds.

*Increase on Program Expenses.* MHESO may increase Program Expenses beyond the limit set forth in the respective Supplemental Indenture with a subsequent Cash Flow Projection satisfying the Cash Flow Condition and Credit Confirmation. If Program Expenses are increased pursuant to the prior sentence, MHESO shall give notice of such to the Rating Agency.

*Recycling Limitations.* Student Loans may be purchased, originated or refinanced under the General Indenture, with proceeds of the respective series of 2004 Series Bonds or other amounts credited to the Taxable Accounts (created pursuant to the Sixth Supplemental Indenture) and the 2004 Series B Accounts (created pursuant to the Seventh Supplemental Indenture), (i) prior to July 1, 2007, provided that if, prior to that date, the Credit Provider requests a Cash Flow Projection and such Cash Flow Projection fails to demonstrate that any proposed purchase, origination or refinancing of Student Loans will not materially adversely affect the Issuer's ability to pay Debt Service on the Outstanding Bonds, amounts payable to Liquidity Providers, Credit Providers, Carry-Over Amounts (including accrued interest thereon) with respect to Outstanding Bonds, Program Expenses or to make required deposits to the credit of the Rebate Fund and the Excess Interest Fund, the Credit Provider may direct the Issuer not to purchase, originate or refinance Student Loans from such proceeds or amounts; and (ii) on and after July 1, 2007, with the written consent of the Credit Provider, which consent shall not be unreasonably withheld, with notice to the Rating Agency.

*Creation of Subaccounts for 2004 Series Bonds.*

(a) For purposes of tracking amounts and loans attributable to the 2004 Series A Bonds, the Trustee shall establish a separate subaccount entitled the Taxable Account in each of the Acquisition Fund, the Debt Service Reserve Fund and the Student Loan Fund and these subaccounts shall be administered in the same manner as the Fund in which such subaccount is created as provided in the General Indenture, provided, however, as follows: (1) Amounts transferred to the Acquisition Fund attributable to the 2004 Series A Bonds shall be deposited in the Taxable Account of the Acquisition Fund as provided in Section 3.1 of the Sixth Supplemental Indenture; and (2) Student Loans acquired with proceeds of or attributable to the 2004 Series A Bonds shall be credited to the Taxable Account of the Student Loan Fund. In addition, Student Loans acquired with amounts on deposit in the Taxable Account of the Revenue Fund or the Surplus Fund shall be credited to the Taxable Account of the Student Loan Fund.

(b) The Trustee shall also establish separate subaccounts entitled the Taxable Accounts in the Revenue Fund and the Surplus Fund, which subaccounts shall be administered in accordance with the last paragraphs of Section 5.4 and Section 5.6 of the General Indenture, as applicable. Within the Taxable Account of the Revenue Fund a deposit shall be made to the Capitalized Interest Subaccount in the amount set forth in the Sixth Supplemental Indenture.

(c)(i) Amounts remaining in the 1999 Series Accounts of the Debt Service Reserve Fund, the Acquisition Fund, the Student Loan Fund, the Revenue Fund and the Surplus Fund, all as created by the First Supplemental Indenture, shall be deposited by the Trustee on the Closing Date in the Taxable Accounts of such respective Funds, created pursuant to the Sixth Supplemental Indenture. Following such deposits, all 1999 Series Accounts referred above shall be closed by the Trustee. On and after the Closing Date, all deposits to be made to such 1999 Series Accounts pursuant to the First Supplemental Indenture shall be made to the Taxable Accounts of the respective Funds.

(c)(ii) Amounts remaining in the 2002 Series A Accounts of the Debt Service Reserve Fund, the Acquisition Fund, the Student Loan Fund, the Revenue Fund and the Surplus Fund, all as created by the Second Supplemental Indenture, shall be deposited by the Trustee on the Closing Date in the Taxable Accounts of such respective Funds, created pursuant to the Sixth Supplemental Indenture. Following such deposits, all 2002 Series A Accounts referred above shall be closed by the Trustee. On and after the Closing Date, all deposits to be made to such 2002 Series A Accounts pursuant to the Second Supplemental Indenture shall be made to the Taxable Accounts of the respective Funds.

(c)(iii) Amounts remaining in the 2003 Series A Accounts of the Debt Service Reserve Fund, the Acquisition Fund, the Student Loan Fund, the Revenue Fund and the Surplus Fund, all as created by the Fourth Supplemental Indenture, shall be deposited by the Trustee on the Closing Date in the Taxable Accounts of such respective Funds, created pursuant to the Sixth Supplemental Indenture. Following such deposits, all 2003 Series A Accounts referred above shall be closed by the Trustee. On and after the Closing Date, all deposits to be made to such 2003 Series A Accounts pursuant to the Fourth Supplemental Indenture shall be made to the Taxable Accounts of the respective Funds.

(d) The yield restriction provisions of Section 5.6 (governing the Surplus Fund) and Section 5.8 (governing the Acquisition Fund) of the General Indenture shall not apply to the Taxable Accounts of the Surplus Fund and the Acquisition Fund (due to the fact that the 1999 Series Bonds, 2002 Series A Bonds, 2003 Series A Bonds, and 2004 Series A Bonds are Federally Taxable Bonds).

(e) For purposes of tracking amounts and loans attributable to the 2004 Series B Bonds, the Trustee shall establish a separate subaccount entitled the 2004 Series B Account in each of the Acquisition Fund, the Debt Service Reserve Fund and the Student Loan Fund and these subaccounts shall be administered in the same manner as the Fund in which such subaccount is created as provided in the General Indenture, provided, however, as follows: (1) Amounts transferred to the Acquisition Fund attributable to the 2004 Series B Bonds shall be deposited in the 2004 Series B Account of the Acquisition Fund as provided in Section 3.1 of the Seventh Supplemental Indenture; and (2) Student Loans acquired with proceeds of or attributable the 2004 Series B Bonds shall be credited to the 2004 Series B Account of the Student Loan Fund. In addition, Student Loans acquired with amounts on deposit in the 2004 Series B Account of the Revenue Fund or the Surplus Fund shall be credited to the 2004 Series B Account of the Student Loan Fund.

(f) The Trustee shall also establish separate subaccounts entitled the 2004 Series B Account in the Revenue Fund and the Surplus Fund, which subaccounts shall be administered in accordance with the last paragraphs of Section 5.4 and Section 5.6 of the General Indenture, as applicable. Within the 2004 Series B Account of the Revenue Fund the Capitalized Interest Subaccount shall be established with the amount set forth in Section 3.1 of the Seventh Supplemental Indenture. The moneys in the Capitalized Interest Subaccount will be used to pay interest on the 2004 Series B Bonds to the extent other amounts available therefor in the Revenue Fund are insufficient. If any monies are remaining in a Capitalized Interest Subaccount on December 1, 2004, they shall be transferred by the Trustee to the related Revenue Fund on December 1, 2004.

*Limitation on Sale of Loans.* In the event that the sum of the value of (a) the Student Loans (valued at par plus accrued interest) credited to the Student Loan Fund, other than Defaulted Student Loans, and (b) all cash and Investment

Securities held in the Funds and Accounts (valued as set forth in the General Indenture, the Sixth Supplemental Indenture or the Seventh Supplemental Indenture, plus accrued interest, but excluding amounts irrevocably set aside to pay particular Bonds pursuant to Section 12.1 of the General Indenture) shall be less than 100% of the sum of principal and accrued interest on all Outstanding Bonds (other than Class V Bonds), MHESO shall not direct the sale of Student Loans except as provided in Section 3.7 of the Sixth Supplemental Indenture or Section 3.7 of the Seventh Supplemental Indenture, unless MHESO shall have received a Rating Confirmation and Credit Confirmation for such series of 2004 Series Bonds (all as calculated and determined by MHESO and evidenced in a Certificate of an Authorized Representative to the Trustee).

*Purchase of Defaulted Student Loans.* The Issuer shall calculate the Senior Asset Coverage Ratio quarterly, beginning with the quarter ended September 30, 2004, and provide such calculation to the Trustee and the Credit Provider. To the extent the Senior Asset Coverage Ratio so calculated is below 101% for any calendar quarter, the Issuer shall purchase or replace any Student Loan in the applicable account of the Student Loan Fund that becomes a Defaulted Student Loan during the succeeding calendar quarter from any available funds of the Issuer not held under the Indenture, including, without limitation, amounts in the Issuer's Loan Capital Fund.

To the extent the Issuer is required to so purchase or replace any Defaulted Student Loan in the applicable account of the Student Loan Fund, it shall do so within 45 days after such Student Loan becomes a Defaulted Student Loan. If the Issuer elects to purchase the Defaulted Student Loan, the purchase price shall be par plus accrued interest, if any. If the Issuer replaces such a Defaulted Student Loan with a new Student Loan, such replacement Student Loan shall have a principal balance and accrued interest thereon at least equal in the aggregate to that of the Defaulted Student Loan and the maturity of the replacement Student Loan shall not be later than the final stated maturity of the applicable series of Bonds, shall be credited to the applicable account of the Student Loan Fund and shall be deemed to have been acquired with the proceeds of the applicable series of Bonds.

To the extent that Defaulted Student Loans are not being purchased by the Issuer's Loan Capital Fund, any recovery of amounts with respect to any such Defaulted Student Loans shall be credited to the applicable account of the Revenue Fund.

If the Issuer fails to purchase or replace any Defaulted Student Loan as required hereunder, the Issuer shall notify the Rating Agency of such failure and the Trustee may with the consent of the Credit Provider and shall at the direction of the Credit Provider pursue all available remedies as set forth in Article X of the General Indenture and any recovery of amounts with respect to any such Defaulted Student Loan shall be credited to the applicable account of the Revenue Fund.

*Financial Covenant.*

(a) Within 45 days after each March 31, June 30, September 30 and December 31, MHESO shall maintain with the State Treasurer cash in an amount equal to one percent (1%) of all SELF II Student Loans and SELF III Student Loans outstanding,

(b) MHESO shall not permit its Tangible Net Worth at any time to be less than \$100,000,000,

(c) MHESO shall not permit the ratio of (1) the sum of (i) 33% of any bonds of MHESO as to which no expenses are expected to be paid from the MHESO's Loan Capital Fund nor is there an expectation that defaulted student loans will be repurchased from funds in the Loan Capital Fund or replaced with loans from the Loan Capital Fund; (ii) 66% of any bonds of MHESO as to which only (a) expenses of the bonds are expected to be paid from the Loan Capital Fund or (b) repurchase or replacement of student loans which are defaulted student loans are from funds or loans in the Loan Capital Fund plus (iii) 100% of any bonds of MHESO as to which expenses or any other amounts are expected to be paid from MHESO's Loan Capital Fund, divided by (2) Tangible Net Worth, to be greater than four and one-half to one (4.5); provided however, that the percentage referred to in clause (ii) above shall be adjusted as follows: as of the most recent quarterly calculation, if the Senior Asset Coverage Ratio is 101% or lower, the percentage shall be 100%, if the Senior Asset Coverage Ratio is 101.5% or lower but greater than 101%, the percentage shall be 90% and if the Senior Asset Coverage Ratio is 102% or lower but greater than 101.5%, the percentage shall be 80%,



(d) MHESO shall maintain \$3,400,000 in cash and Investment Securities in its Loan Capital Fund which mature in less than one (1) year, provided that after December 31, 2004, MHESO shall maintain \$3,200,000 in cash and Investment Securities in its Loan Capital Fund which mature in less than one (1) year and

(e) The Issuer shall not permit its Tangible Net Worth less any loans to the State of Minnesota to be less than \$290,000,000 on or after June 30, 2004, \$305,000,000 on or after June 30, 2005, \$325,000,000 on or after June 30, 2006, \$340,000,000 on or after June 30, 2007, \$360,000,000 on or after June 30, 2008, \$380,000,000 on or after June 30, 2009, \$400,000,000 on or after June 30, 2010, \$425,000,000 on or after June 30, 2011, \$450,000,000 on or after June 30, 2012, \$475,000,000 on or after June 30, 2013 and \$500,000,000 on or after June 30, 2014 and thereafter until no 2004 Series Bonds are outstanding. The failure of the Issuer to comply with this covenant shall not constitute an Event of Default under the Sixth Supplemental Indenture or the Seventh Supplemental Indenture unless MHESO has withdrawn moneys from the Loan Capital Fund for a purpose other than to pay expenses related to the administration of loans made by MHESO, to make loans under the Supplemental Student Loan Program or to repurchase defaulted student loans held under an indenture.

(f) The Issuer shall not issue any bonds, notes or other obligations (including Additional Bonds to be issued under the General Indenture) (the "New Bonds") unless at the time of such issuance the Issuer is not in default under the General Indenture or the Insurance Agreement or with respect to any bonds, notes or other obligations of the Issuer issued under any other indenture and:

- (1) the Credit Provider issues a Credit Facility with respect to such New Bonds; or
- (2) if the New Bonds are not subject to bond insurance or other form of credit enhancement, the Issuer provides to the Trustee written evidence from each rating agency rating such New Bonds that such New Bonds shall be rated in one of the three highest Rating Categories; and
- (3) as to any bonds, notes or other obligations of the Issuer which are currently outstanding and not secured by bond insurance or other form of credit enhancement ("Unenhanced Bonds"), the Issuer provides to the Trustee written evidence from each rating agency then rating such Unenhanced Bonds that such Unenhanced Bonds shall be rated in one of the three highest Rating Categories upon issuance of such New Bonds; and
- (4) as to any bonds, notes or other obligations of the Issuer which are currently outstanding and secured by a Credit Facility issued by the Credit Provider ("Enhanced Bonds"), the Credit Provider receives evidence from each rating agency then rating such Enhanced Bonds that such Enhanced Bonds, without the benefit of any such Credit Facility, would be rated in one of the three highest Rating Categories upon issuance of such New Bonds.

(g) The Issuer shall not issue any bonds, notes or other obligations, other than Additional Bonds issued under the General Indenture, which will have a greater claim on the assets of the Loan Capital Fund than the claim created under the General Indenture.

(h) The Issuer shall notify the Credit Provider of an event of default with respect to any bonds, notes or other obligations issued by the Issuer including an event of default with respect to any bonds, notes or other obligations not issued under the General Indenture.

*Cash Flow Projections.* MHESO shall, no more frequently than once every twelve months, provide to the Credit Provider, if requested, a Cash Flow Projection.

*Student Loan Requirements.* MHESO covenants that all Student Loans to be acquired under each Supplemental Indenture will meet the following criteria at the time of such acquisition unless otherwise assumed in the Closing Cash Flow Projection for such series of 2004 Series Bonds or if MHESO obtains a Credit Confirmation for such series of 2004 Series Bonds; provided, however, that the provisions of (a) and (b)(1), (2),

(3) and (6) were met only when the Student Loan was made: (a) The borrower of each Student Loan is either enrolled in an Eligible Institution in Minnesota or a Minnesota resident enrolled in an Eligible Institution; (b) The borrower of each Student Loan (1) is enrolled at least half time in a program leading to a certificate, associate, baccalaureate, masters, doctorate or other professional degree, (2) is making satisfactory progress in an approved course of study, (3) is not currently in default under any State, federal or other private student loan program, (4) is not delinquent in the payment of principal or interest on any SELF II or SELF III loan, (5) has agreed to the release of information to a consumer credit reporting agency and (6) has a Creditworthy Cosigner; (c) The interest rate on the Student Loan is (i) variable, adjusted quarterly based upon the average of the weekly 91 day T-Bill auctions (bond equivalent yield), plus a margin, determined by MHESO, (ii) variable adjusted quarterly based upon Three-Month LIBOR, plus a margin, which shall be determined by MHESO, or (iii) an interest rate that has been approved by Credit Confirmation; (d) The maximum loan amount-of the Student Loan according to Grade Level: i.e. \$4,500 per year for undergraduates during Grade Levels 1 and 2, \$6,000 per year for undergraduates during Grade Levels 3, 4 and 5, subject to a maximum of \$25,000 for undergraduate Student Loans and \$9,000 per year for graduate students, and subject to a maximum of \$40,000 including undergraduate and graduate Student Loans; (e) For each Student Loan, the quarterly interest payments begin within 3 months of disbursement of such Student Loan, monthly interest payments are required for 12 months after the borrower leaves school, monthly principal and interest payments begin on the 13th month after graduation or termination of study, subject to a maximum repayment term equal to the lesser of (i) 10 years from graduation/termination, or (ii) 15 years from initial disbursement. An additional 24-month period of interest only payments after the standard 12-month grace period is available upon request, subject to the same maximum repayment terms described above; (f) Payment notices are sent to each borrower at least 20 days prior to the payment due date and if payment is not received on the due date it is considered late, and (i) late notices are sent beginning on the 15th day of delinquency; (ii) payment demands upon the Creditworthy Cosigner begin on the 30th day of delinquency and (iii) the loan is considered in default on the 165th day of delinquency.

*Perfection of Student Loans and Defaulted Student Loans.* The Trustee shall have a first perfected security interest in all Student Loans; provided that the foregoing shall not prevent the Servicer from releasing possession to MHESO of the related promissory notes and other documentation with respect to Student Loans in default in accordance with the provisions of the Servicing Agreement, unless the Default Rate exceeds 10% on any Default Rate Calculation Date, and, in such case, (i) the Servicer shall not release possession to the Issuer of the related promissory notes and other documentation with respect to Student Loans in default, and (ii) the Issuer shall notify the Rating Agency of such Defaulted Student Loans.

*Margin Requirements on Student Loans.* MHESO must obtain Credit Confirmation to reduce the margin referred to in Section 3.10 (c)(i) of the respective Supplemental Indentures to be less than 2.00 percent or referred to in Section 3.10(c)(ii) of the respective Supplemental Indentures to be less than 2.50 percent of the amount that MHESO charges on Student Loans.

*Servicing of Student Loans.* MHESO will perform an audit of the Servicer at least once each calendar year and provide such report to the Credit Provider. Upon the request of the Credit Provider, upon the occurrence of a Default or an Event of Default hereunder, the Issuer will perform an additional audit of the Servicer to ensure that the Servicer is complying with the terms of the Servicing Agreement and the rules and regulations of MHESO and provide such report to the Credit Provider. Such report shall report such compliance in writing (or otherwise describe any noncompliance in such detail as shall be reasonably satisfactory to the Credit Provider, and MHESO shall provide such report to the Credit Provider. In the event that MHESO is notified (whether by such accountants or otherwise) of any material noncompliance by the Servicer with the due diligence standards, MHESO shall use its best efforts to cause the Servicer to do all things necessary to cure such noncompliance. If a required audit of the Servicer is not received within 30 days after the time required or if the Servicer shall fail to cure noncompliance described in the preceding sentence within 60 days after MHESO received notice thereof, MHESO shall, at the request of the Credit Provider arrange for the prompt substitution of a Servicer for the Student Loans satisfactory to the Credit Provider and MHESO under a Servicing Agreement granting rights substantially identical to the rights granted under the initial Servicing Agreement with respect to the Student Loans or otherwise satisfactory to the Credit Provider. MHESO covenants that the Servicing Agreement shall provide that MHESO may terminate the Servicing Agreement and will, at the direction of the Credit Provider, if the Servicer refuses or fails to perform in a material fashion any part of its obligations under the Servicing Agreement, and fails or refuses to correct said action or lack of action within sixty (60) days after written notice, to the Servicer. All written information required under Section 3.13 of the respective Supplemental Indenture, shall be delivered within 15 days after receipt thereof by

MHESO. MHESO covenants that all amendments to the Servicing Agreement will be consented to by the Credit Provider. MHESO covenants that the Servicing Agreement shall provide that the Servicer shall service the Student Loans if the Credit Provider is the owner of the Student Loans (a third-party beneficiary) and the Credit Provider pays the fees for such accounts. MHESO covenants that pursuant to the Servicing Agreement, the Servicer will act as bailee and agent of the Student Loans for the Trustee. MHESO covenants that the Servicing Agreement shall provide that the Servicer shall hold all the Student Loan notes except notes released to MHESO with respect to Student Loans as to which a payment is delinquent by 120 days or more; provided that no such release will be permitted under the terms of the Servicing Agreement if the Default Rate exceeds 10% on any Default Rate Calculation Date.

*Additional Student Loan Requirements.* MHESO covenants that, unless MHESO receives a Credit Confirmation permitting otherwise, upon the purchase, origination or refinancing of any Student Loans under the Indenture, the percentage of the aggregate principal balance of Student Loans after such purchase, origination or refinancing represented by Student Loans which relate to proprietary and vocational schools will not exceed by any material amount (which, for this purpose, will be assumed to be 10% or more) the percentage of the aggregate principal balance of all student loans owned at that time by the Issuer represented by loans which relate to proprietary and vocational schools. In addition; no Student Loans made to students attending institutions with Cohort Default Rates greater than 20% shall be acquired; refinanced or originated if, and to the extent, such acquisition, refinancing or origination would cause the aggregate principal amount of Student Loans made to students attending institutions with Cohort Default Rates greater than 20% to exceed 8% of the Student Loans, which limit can be waived with MBIA consent. Once the Student Loans made to students attending institutions with Cohort Default Rates greater than 20% exceeds 5% of the Student Loans; the Issuer will report annually to the Credit Provider the volume by school. "Cohort Default Rate" means the percentage of borrower defaults on loans made to borrowers attending a particular eligible institution (defined in the Higher Education Act), which at any time shall be the Secretary of Education's most recently publicly available calculation of the fiscal year cohort default rate for such eligible institution.

## **Credit Provider**

*Rights of Insurer Controlling.* Anything contained in the Sixth Supplemental Indenture or the Seventh Supplemental Indenture to the contrary notwithstanding, if the Credit Facility is in effect with respect to the related series of 2004 Series Bonds and the Credit Provider is not in default of its obligation to make payments thereunder; the Credit Provider shall be deemed to be the Owner of all such related series of 2004 Series Bonds then Outstanding for all purposes (including, without limitation, all approvals, consents, waivers, authorizations, directions, inspections and the institution of any action), provided that nothing in Section 4.1 of the Sixth Supplemental Indenture or the Seventh Supplemental Indenture shall impair the rights of the Bondholders to receive all payments due under the related series of 2004 Series Bonds, and shall have the exclusive right to exercise or direct the exercise of remedies on behalf of the Owners of the related series of 2004 Series Bonds in accordance with the terms of the General Indenture, the Sixth Supplemental Indenture and the Seventh Supplemental Indenture, as applicable, following an Event of Default, and the principal of all such series of 2004 Series Bonds Outstanding may not be declared to be due and payable immediately without the prior written consent of the Credit Provider.

*Payments Under the Credit Facility.* If, as of the second Business Day next preceding any date on which payment of principal or interest on each series of 2004 Series Bonds is due, there are insufficient moneys available under the General Indenture to pay all principal and interest coming due on such series of 2004 Series Bonds on the next succeeding payment date, the Trustee shall immediately notify the Credit Provider or its designee by telephone or facsimile, confirmed in writing by registered or certified mail, of the amount of the deficiency. If the deficiency is made up in whole or in part prior to or on the Interest Payment Date or Principal Payment Date, the Trustee shall so notify the Credit Provider or its designee. In addition, if the Trustee has notice that any of the Bondholders have been required to disgorge payments of principal or interest on a series of 2004 Series Bonds to MHESO or to the trustee in bankruptcy for creditors or others pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes a voidable preference to such Bondholders within the meaning of any applicable bankruptcy laws, then the Trustee shall notify the Credit Provider or its designee of such fact by telephone or telegraphic notice, confirmed in writing by registered or certified mail. The Trustee is irrevocably designated, appointed, directed and authorized to act as attorney-in-fact for Bondholders of the 2004 Series Bonds as follows: (i) if and to the extent there is a deficiency in amounts required to pay interest on a series of 2004 Series Bonds, the

Trustee shall (A) execute and deliver to the Insurance Paying Agent, in form satisfactory to the Insurance Paying Agent, an instrument appointing the Credit Provider as agent for such Bondholder in any legal proceedings related to the payment of such interest and an assignment to the Credit Provider of the claims for interest to which such deficiency relates and which are paid by the Credit Provider, (B) receive as designee of the respective Bondholders (and not as Trustee) in accordance with the tenor of the Credit Facility payment from the Insurance Paying Agent with respect to the claims for interest so assigned and (C) disburse the same to such respective Bondholders; (ii) if and to the extent of a deficiency in amounts required to pay principal of the related series of 2004 Series Bonds, the Trustee shall (A) execute and deliver to the Insurance Paying Agent an instrument appointing the Credit Provider as agent for such Bondholder in any legal proceeding relating to the payment of such principal and assignment to the Credit Provider of any of the related series of 2004 Series Bonds surrendered to the Insurance Paying Agent of so much of the principal amount thereof as has not previously been paid or for which moneys are not held by the Trustee and available for such payment (but such assignment shall be delivered only if payment from the Insurance Paying Agent is received), (B) receive as designee of the respective Bondholders (and not as Trustee) in accordance with the tenor of the Credit Facility payment therefor from the Insurance Paying Agent and (C) disburse the same to such Bondholders. Payments with respect to claims for interest on and principal of a series of 2004 Series Bonds disbursed by the Trustee from proceeds of the Credit Facility shall not be considered to discharge the obligation of MHESO with respect to such series of 2004 Series Bonds, and the Credit Provider shall become the owner of such unpaid series of 2004 Series Bond and claims for interest in accordance with the tenor of the assignment made to it. Irrespective of whether any such: assignment is executed and delivered, MHESO and the Trustee agree for the benefit of the Credit Provider that; (i) they recognize that to the extent the Credit Provider makes payments, directly or indirectly (as by paying through the Trustee), on account of principal of or interest on the 2004 Series Bonds, the Credit Provider will be subrogated to the rights of such Bondholders to receive the amount of such principal and interest from MHESO, with interest thereon as provided and solely from the sources stated in the respective Supplemental Indentures and the related 2004 Series Bonds; and (ii) they will accordingly pay to the Credit Provider the amount of such principal and interest (including principal and interest recovered under subparagraph (ii) of the first paragraph of the Credit Facility, which principal and interest shall be deemed past due and not to have been paid), with interest thereon as provided in the respective Supplemental Indentures and the related 2004 Series Bond, but only from the sources and in the manner provided for the payment of principal of and interest on the related 2004 Series Bonds to Bondholders and will otherwise treat the Credit Provider as the owner of such rights to the amount of such principal and interest.

*Notices, Consents, Miscellaneous.* In connection with the issuance of additional Bonds, if any, under the General Indenture, MHESO shall deliver to the Credit Provider a copy of the disclosure document, if any, circulated with respect to such additional Bonds. No amendment or supplement shall be made to the General Indenture, the Sixth Supplemental Indenture, the Seventh Supplemental Indenture, the Auction Agency Agreements, the Market Agent Agreements or the Broker-Dealer Agreements without prior written consent of the Credit Provider. The Credit Provider shall receive notice of the resignation or removal of the Trustee and any successor trustee must be approved by the Credit Provider. The Credit Provider shall also receive notice of the resignation or removal of any Paying Agent and any successor paying agent must be approved by the Credit Provider. While the Credit Facility is in effect for a series of 2004 Series Bonds, the Trustee will furnish the Credit Provider with such information as it may reasonably request regarding such series of 2004 Series Bonds, as appears from the books and records under its custody and control, or as otherwise known to it. The Trustee will permit the Credit Provider to have access to and make copies of all such books and records at any reasonable time. While the Credit Facility is in effect, MHESO agrees to permit the Credit Provider to examine, visit and inspect, at any reasonable time, upon reasonable notice, the Student Loans acquired, originated or refinanced with the net proceeds of the 2004 Series Bonds, and its facilities, and any accounts, books and records, including their receipts, disbursements, contracts, investments and any other matters relating thereto and to their financial standing, and to supply such reports and information as the Credit Provider may reasonably require. MHESO's chief financial officer shall, at the reasonable request of the Credit Provider, discuss its financial matters with the Credit Provider or a designee and provide the Credit Provider with copies of any documents that are reasonably requested by the Credit Provider or a designee and have a material financial affect on it. The Credit Provider shall be notified by the Trustee (i) immediately upon the occurrence of an Event of Default or of any event that with notice and/or with the lapse of time could become an Event of Default, and (ii) of any redemption of a series of 2004 Series Bonds at the same time that the Bondholders of such series of 2004 Series Bonds to be redeemed are notified. Notwithstanding any other provision to the contrary in the Sixth Supplemental Indenture or the Seventh Supplemental Indenture, the Credit Provider is an express third-party beneficiary and may enforce the Sixth Supplemental Indenture or the Seventh Supplemental Indenture as if a party thereto.

*Consents, etc. by Credit Provider Limited.* Notwithstanding any other provision of the Sixth Supplemental Indenture or the General Indenture to the contrary, no consent of or notice to the Credit Provider shall be required under any provision of the Sixth Supplemental Indenture or the General Indenture nor shall the Credit Provider have any right to receive notice of, consent to, direct or control any actions, restrictions, rights, remedies; waivers or accelerations pursuant to any provision of the Sixth Supplemental Indenture or the General Indenture after the Credit Facility has expired or during any time which (a) the Credit Provider is in default in its obligation under the Credit Facility, (b) the Credit Facility for any reason ceases to be valid and binding on the Credit Provider or is declared to be null and void, or the validity or enforceability of any material provision of the Credit Facility is denied by the Credit Provider or any governmental agency or authority, or the Credit Provider is denying further liability or obligation under the Credit Facility, contrary to the terms of the Credit Facility, (c) a petition has been filed and is pending against the Credit Provider under any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law of any jurisdiction, whether now or hereafter in effect, and has not been dismissed within thirty (30) days after such filing, or (d) the Credit Provider has filed a petition, which is pending, under any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law of any jurisdiction, whether now or hereafter in effect, or has consented to the filing of any petition against it under such law.

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**APPENDIX III**

**AUCTION PROCEDURES**

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## AUCTION PROCEDURES

The following description has been provided by the Underwriter, and MHESO assumes no responsibility for the accuracy of the information contained herein. No assurance can be given that the procedures described herein will not change subsequent to the date hereof. The Auction Procedures for the 2004 Series Bonds, while outstanding as RAMS, are as set forth below. All of the terms used in this Appendix III are defined herein or in other parts of this Official Statement.

### Definitions

"AA' Composite Commercial Paper Rate", on any date of determination, shall mean (i) the interest equivalent of the 30-day rate on commercial paper placed on behalf of issuers whose corporate bonds are rated "AA" by S&P or the equivalent of such rating by a nationally recognized rating agency, as such 30-day rate is made available on a discount basis or otherwise by the Federal Reserve Bank of New York for the Business Day immediately preceding such date of determination; or (ii) if the Federal Reserve Bank of New York does not make available any such rate, then the arithmetic average of the interest equivalent of the 30-day rate on commercial paper placed on behalf of such issuers, as quoted to the Auction Agent on a discount basis or otherwise, by at least three dealers of commercial paper, or such fewer entities as may then be dealers of commercial paper, as of the close of business on the Business Day immediately preceding such date of determination. For purposes of this definition, the "interest equivalent" of a rate stated on a discount basis (a "*discount rate*") for commercial paper of a given day's maturity shall be equal to the product of (A) 100 times (B) the quotient (rounded upwards to the next higher one-thousandth (.001) of 1%) of (x) the discount rate (expressed in decimals) divided by (y) the difference between (1) 1.00 and (2) a fraction the numerator of which shall be the product of the discount rate (expressed in decimals) times the number of days in which such commercial paper matures and the denominator of which shall be 360.

"Adjustable Rate" means an Auction Rate or any other rate of interest which may change from time to time but shall not exceed the Interest Rate Limitation.

"After-Tax Equivalent Rate" means, on any Auction Date, the interest rate per annum equal to the product of (i) the AA Composite Commercial Paper Rate on such date and (ii) 1.00 minus the lower of the Statutory Corporate Tax Rate and the Statutory Personal Tax Rate on such date. For purposes of this definition, the term "Statutory Corporate Tax Rate" means, as of any date of determination, the highest tax rate bracket (expressed in decimals) now or hereafter applicable in each taxable year on the taxable income of every corporation as set forth in Section 11 of the Code or any successor section without regard to any minimum additional tax provision or provisions regarding changes in rates during the taxable year, which on the date hereof is .35; and "Statutory Personal Tax Rate" means, as of any date of determination, the highest tax rate bracket (expressed in decimals) now or hereafter applicable in each taxable year on the taxable income of a natural person as set forth in Section 1 of the Code or any successor section without regard to any minimum additional tax provision or provisions regarding changes in rates during a taxable year, which on the date hereof is .35.

"All Hold Rate" on any date of determination, shall mean, with respect to the 2004 Series A Bonds, the interest rate per annum equal to 90% of the Applicable LIBOR Rate, rounded to the nearest one thousandth (.001) of 1%; provided that in no event shall the All Hold Rate be more than the Interest Rate Limitation or less than zero, and, with respect to the 2004 Series B Bonds, the interest rate per annum equal to 90% (as such percentage may be adjusted pursuant to the Seventh Supplemental Indenture) of the lesser of (a) the After-Tax Equivalent Rate on such date or (b) the Kenny Index on such date, rounded down to the nearest one thousandth (.001) of 1%; provided, however, that in no event shall such All Hold Rate be more than the Interest Rate Limitation or less than zero.

"Applicable LIBOR Rate" means with respect to the 2004 Series A Bonds (i) for Auction Periods of 28 days or less, One-Month LIBOR, (ii) for Auction Periods of more than 28 days but less than 91 days, Three-Month LIBOR, (iii) for Auction Periods of more than 90 days but less than 181 days, Six-Month LIBOR, and (iv) for Auction Periods of more than 180 days, One-Year LIBOR. As used in this definition and otherwise herein, the terms "One-Month LIBOR," "Three-Month LIBOR," "Six-Month LIBOR" or "One-Year LIBOR" mean the rate of interest per annum equal to the rate per annum at which United States dollar deposits having a maturity of one-month, three months, six months or one year, respectively, are offered to prime banks in the London Interbank market which

appear on the Reuters Screen LIBOR Page as of approximately 11:00 a.m., London time, on the Determination Date. If at least two such quotations appear, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, will be the arithmetic mean (rounded upwards, if necessary, to the nearest one-hundredth of one percent) of such offered rates. If fewer than two such quotes appear, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, with respect to such Interest Period will be determined at approximately 11:00 a.m., London time, on such Determination Date on the basis of the rate at which deposits in United States dollars having a maturity of one month, three months, six months or one year, respectively, are offered to prime banks in the London Interbank market by four major banks in the London Interbank market selected by the Auction Agent or the Trustee, as applicable, and in a principal amount of not less than U.S. \$1,000,000 and that is representative for a single transaction principal London office of each of such banks to provide a quotation of its rate. If at least two quotations are provided, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, will be the arithmetic mean (rounded upwards, if necessary, to the nearest one-hundredth of one percent) of such offered rates. If fewer than two quotations are provided, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, with respect to such Interest Period will be the arithmetic mean (rounded upwards, if necessary, to the nearest one-hundredth of one percent) of the rates quoted at approximately 11:00 a.m., New York City time on such Determination Date by three major banks in New York, New York selected by the Auction Agent or the Trustee, as applicable, for loans in United States dollars to leading European banks having a maturity of one month, three months, six months or one year, respectively, and in a principal amount equal to an amount of not less than U.S. \$1,000,000 and that is representative for a single transaction in such market at such time; provided, however, that if the banks selected as aforesaid are not quoting as mentioned in this sentence, One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, in effect for the applicable Interest Period will be One-Month LIBOR, Three-Month LIBOR, Six-Month LIBOR or One-Year LIBOR, respectively, in effect for the immediately preceding Interest Period.

"*Applicable RAMS Rate*" means, with respect to any 2004 Series A Bonds while bearing interest determined pursuant to the Auction Procedures, the Auction Rate at the time in effect for such 2004 Series A Bonds.

"*Applicable Percentage*" on any date of determination, means, for the 2004 Series B Bonds, the percentage determined based on the rating of the 2004 Series B Bonds in effect at the close of business on the Business Day immediately preceding such date, or, if the 2004 Series B Bonds are then rated by more than one Rating Agency, based on the lower of such ratings on such Business Day, as set forth below:

#### CREDIT RATING

<u>Standard &amp; Poor's</u>	<u>Moody's Investors Service</u>	<u>Fitch Ratings</u>	<u>Applicable Percentage</u>
"AAA"	"Aaa"	"AAA"	175%
"AA-" to "AA+"	"Aa3" to "Aa1"	"AA-" to "AA+"	175%
"A-" to "A+"	"A3" to "A1"	"A-" to "A+"	175%
"BBB-" to "BBB+"	"Baa3" to "Baa1"	"BBB-" to "BBB+"	200%
Below "BBB-"	Below "Baa3"	Below "BBB-"	250%

as such percentages may be adjusted pursuant to the Seventh Supplemental Indenture; provided, that if the 2004 Series B Bonds are not then rated by a Rating Agency, or if a Payment Default shall have occurred and be continuing, the Applicable Percentage shall be 250%, as such percentage may be adjusted pursuant to the Seventh Supplemental Indenture. For purposes of this definition, the rating categories listed above refer to and include the respective rating categories correlative thereto if any Rating Agency has changed or modified its generic rating categories or no longer rates the 2004 Series B Bonds or has been replaced.

"*Applicable Spread*" shall mean, for the 2004 Series A Bonds, on any date of determination, the following percentages, based on the lowest rating assigned to the 2004 Series A Bonds on such date:

#### CREDIT RATING

<u>Standard &amp; Poor's</u>	<u>Moody's Investors Service</u>	<u>Fitch Ratings</u>	<u>Applicable Spread</u>
"AAA"	"Aaa"	"AAA"	1.25
"AA-" to "AA+"	"Aa3" to "Aa1"	"AA-" to "AA+"	1.25
"A-" to "A+"	"A3" to "A1"	"A-" to "A+"	1.25
"BBB-" to "BBB+"	"Baa3" to "Baa1"	"BBB-" to "BBB+"	1.50
Below "BBB-"	Below "Baa3"	Below "BBB-"	2.00

"*Auction Agency Agreement*" shall mean the related Auction Agency Agreement, dated as of July 1, 2004, among the Trustee, MHESO and the initial Auction Agent and any similar agreement with a successor Auction Agent, in each case as from time to time amended or supplemented.

"*Auction Date*" shall mean the initial auction date specified in the related Supplemental Indenture, and thereafter, the Business Day immediately preceding the first day of each Auction Period, other than;

- (a) an Auction Period which commences on, (i) with respect to the 2004 Series A Bonds, a Fixed Rate Conversion Date, and (ii) with respect to the 2004 Series B Bonds, a Conversion Date;
- (b) each Auction Period commencing after the ownership of each series of the related 2004 Series Bonds is no longer maintained in Book-Entry Form by the Security Depository;
- (c) each Auction Period commencing after the occurrence and during the continuance of a Payment Default; or
- (d) any Auction Period commencing less than two Business Days after the cure of waiver of a Payment Default.

Notwithstanding the foregoing, the Auction Date for one or more Auction Periods may be changed pursuant to the related Supplemental Indenture.

"*Auction Period*" shall mean, with respect to a series of the 2004 Series Bonds, the respective Interest Period applicable as the same may be changed pursuant to the related Supplemental Indenture with a Credit Confirmation.

"*Bond Equivalent Yield*" shall mean, with respect to any security with a maturity of six months or less the rate for which is quoted in *The Wall Street Journal* on a bank discount basis, the yield calculated in accordance with the following formula and rounded up to the nearest one one-hundredth of one percent:

$$\frac{R \times N}{360 - (N \times D)} \times 100$$

where "R" refers to the interest rate per annum for the security quoted on a bank discount basis expressed as a decimal, "N" refers to 365 or 366 days, as applicable, and "D" refers to the number of days to maturity.

"*Broker-Dealer*" means, initially, RBC Dain Rauscher Inc., and any other broker or dealer (as defined in the Securities Exchange Act of 1934, as amended), commercial bank or other entity permitted by law to perform the functions required of a Broker-Dealer set forth in the Auction Procedures that is a Participant (or an affiliate of a Participant), has been selected by MHESO with a Credit Confirmation pursuant to the related Supplemental Indenture and has entered into a Broker-Dealer Agreement that remains effective.

"*Broker-Dealer Agreement*" means each agreement between the Auction Agent and a Broker-Dealer pursuant to which the Broker-Dealer agrees to participate in Auctions as set forth in the Auction Procedures, as from time to time amended or supplemented with a Credit Confirmation. Each Broker-Dealer Agreement shall be substantially in the form of the Broker-Dealer Agreement, dated as of July 1, 2004, between the Auction Agent and the initial Broker-Dealer.

"*Business Day*" means:

- (a) with respect to the 2004 Series A Bonds, any day other than a Saturday, Sunday or other day on which the New York Stock Exchange or banks are authorized or obligated by law or executive order to close in New York, New York, or in the city in which is located the principal office of the Auction Agent as provided in the Auction Agency Agreement, or, as notified to the Auction Agent in writing, in any city in which is located the principal corporate trust office of the Trustee or the Credit Provider, if any, at which claims on the Credit Facility will be made; and
- (b) with respect to the 2004 Series B Bonds, any day other than a Saturday, Sunday or other day on which the New York Stock Exchange or banks are authorized or obligated by law or executive order to close in New York, New York, or in the city in which is located the principal office of the Auction Agent as provided in the Auction Agency Agreement, or, as notified to the Auction Agent in writing, in any city in which is located the principal corporate trust office of the Trustee, ~~or~~ the Credit Provider or the Liquidity Provider, if any, at which claims on the Credit Facility or demands for a draw on, or borrowing or payment under the Liquidity Facility will be made.

"*Calculation Period*" means, with respect to the 2004 Series B Bonds, any daily, weekly, monthly, semiannual, annual or other period for which an Adjustable Rate (other than an Auction Rate) is determined while the 2004 Series B Bonds bear interest at such Adjustable Rate, as specified in the Conversion Supplement providing for such Adjustable Rate.

"*Carry-over Amount*" means, with respect to the 2004 Series A Bonds, so long as they bear interest at the Auction Rate, the amount, if any, by which (i) the interest payable on such 2004 Series A Bonds with respect to a given Auction Period is exceeded by (ii) the interest that otherwise would have been payable with respect to such Auction Period but for the limitation imposed by the Maximum Auction Rate on the interest rate for such Auction Period. To the extent required by the Sixth Supplemental Indenture, interest will accrue on such Carry-over Amount until paid. Any reference to "principal" or "interest" in the Sixth Supplemental Indenture and the 2004 Series A Bonds shall not include within the meanings of such words any Carry-over Amount or any interest accrued on any Carry-over Amount.

"*Change in the Interest Rate Mode*," with respect to the 2004 Series B Bonds, means any change in the Calculation Period for the Adjustable Rate borne by the 2004 Series B Bonds pursuant to the Seventh Supplemental Indenture.

"*Change of Preference Law*" means any amendment to the Code or other statute enacted by the Congress of the United States or any temporary, proposed or final regulation promulgated by the United States Treasury after the date the 2004 Series B Bonds are issued which (i) changes or would change any deduction, credit or other allowance allowable in computing liability for any federal tax with respect to, or (ii) imposes or would impose or reduces or would reduce or increases or would increase any federal tax (including, but not limited to, preference or excise taxes) upon, any interest earned by any owner of the 2004 Series B Bonds.

"*Conversion*" means, with respect to the 2004 Series B Bonds, any Change in the Interest Rate Mode or, with respect to both the 2004 Series A Bonds and the 2004 Series B Bonds, any conversion to a Fixed Rate which has been approved or directed by the Credit Provider.

"*Conversion Supplement*" shall mean, with respect to the 2004 Series A Bonds, any Supplemental Indenture which has been approved by the Credit Provider providing for the conversion of the interest rate on the 2004 Series

A Bonds to a Fixed Rate, and with respect to the 2004 Series B Bonds, any Supplemental Indenture which has been approved by the Credit Provider providing for the conversion of the interest rate on the 2004 Series B Bonds to a different Adjustable Rate or a Fixed Rate..

"*Credit Provider*" means MBIA Insurance Corporation and any successor thereto.

"*Determination Date*" means, with respect to the 2004 Series A Bonds, (a) so long as the 2004 Series A Bonds bear interest at an Auction Rate, each Auction Date, and (b) for the Fixed Rate Period, any date within fifteen days before the Fixed Rate Conversion Date; or, in the case of (b), any other date specified in a Conversion Supplement, and with respect to the 2004 Series B Bonds, (a) so long as the 2004 Series B Bonds bear interest at an Auction Rate, each Auction Date, (b) for any Calculation Period, the first Business Day before such Calculation Period, and (c) for the Fixed Rate Period, any date within fifteen days before the Fixed Rate Conversion Date; or, in the case of (b) or (c), any other date specified in a Conversion Supplement.

"*Eligible Carry-over Make-Up Amount*" means, with respect to the 2004 Series A Bonds, with respect to each Interest Period relating to the 2004 Series A Bonds as to which, as of the first day of such Interest Period, there is any unpaid Carry-over Amount, an amount equal to the lesser of (a) interest computed on the principal balance of the 2004 Series A Bonds in respect to such Interest Period at a per annum rate equal to the excess, if any, of the Maximum Auction Rate over the Auction Rate, together with the unreduced portion of any such excess from prior Interest Periods and (b) the aggregate Carry-over Amount remaining unpaid as of the first day of such Interest Period together with interest accrued and unpaid thereon through the end of such Interest Period.

"*Existing Owner*" shall mean (i) with respect to and for the purpose of dealing with the Auction Agent in connection with an Auction, a Person who is a Broker-Dealer listed in the books of registry at the close of business on the Business Day immediately preceding such Auction and (ii) with respect to and for the purpose of dealing with the Broker-Dealer in connection with an Auction, a Person who is a beneficial owner of a series of the Bonds.

"*Fixed Rate*" shall mean the rate of interest on any series of the Bonds fixed to the maturity thereof and determined pursuant to the related Supplemental Indenture, provided, however, that such rate of interest shall not exceed the related Interest Rate Limitation.

"*Fixed Rate Conversion Date*" shall mean the date on which the Fixed Rate takes effect as provided in the related Supplemental Indenture.

"*Fixed Rate Period*" shall mean the period, if any, during which all or a portion of a series of the 2004 Series Bonds bear interest at a Fixed Rate, which period shall commence on the Fixed Rate Conversion Date and extend through the Stated Maturity Date thereof.

"*Interest Period*" shall mean, with respect to the 2004 Series A Bonds, any Auction Period or the Fixed Rate Period, and, with respect to the 2004 Series B Bonds, any Auction Period, the Calculation Period, or the Fixed Rate Period

"*Interest Rate Limitation*" means the lesser of (i) the maximum rate allowable by applicable law or (ii) while a series of the Bonds bears interest at an Auction Rate, 17% in the case of 2004 Series A Bonds and 14% in the case of 2004 Series B Bonds.

"*Kenny Index*" means the index most recently made available by Kenny S&P Evaluation Services ("Kenny") or any successor thereto (the "Indexing Agent") based upon 30-day yield evaluations at par of securities, the interest on which is excluded from gross income for federal income tax purposes under the Code, of not less than five "Intermediate Grade" component issuers selected by the Indexing Agent which shall include, without limitation, issuers of general obligation bonds. The specific issuers included among the component issuers may be changed from time to time by the Indexing Agent in its discretion. The securities on which the Kenny Index is based shall not include any securities the interest on which is subject to a "minimum tax" or similar tax under the Code, unless all such securities are subject to such tax. In the event that Kenny no longer publishes an index satisfying the above

definition of the Kenny Index or the Market Agent reasonably concludes that the Kenny Index will not be announced in a timely manner, then the Market Agent shall announce a rate based upon the same criteria used by Kenny to determine the Kenny Index and the rate announced by the Market Agent for each Auction Date thereafter shall be used in lieu of the Kenny Index for each Auction Date, and such rate announced by the Market Agent shall for all purposes be deemed to be the "Kenny Index" under the Seventh Supplemental Indenture.

"*Market Agent Agreement*" means the related Market Agent Agreement, dated as of July 1, 2004, between the Trustee and RBC Dain Rauscher Inc. as the initial Market Agent, and any similar agreement with a successor Market Agent approved by the Credit Provider, in each case as from time to time amended or supplemented and approved by the Credit Provider.

"*Maximum Auction Rate*", on any date of determination, shall mean

- (i) for the 2004 Series A Bonds, the lesser of:
  - (A) the Applicable LIBOR Rate plus 1%;
  - (B) the Interest Rate Limitation; or
  - (C) for Auctions after the Initial Auction Date, the T-Bill Cap.
- (ii) for the 2004 Series B Bonds, the lesser of:
  - (A) the Applicable Percentage of the greater of (x) the After-Tax Equivalent Rate on such date or (y) the Kenny Index on such date;
  - (B) the Interest Rate Limitation; or
  - (C) for Auctions after the Initial Auction Date, the T-Bill Cap.

"*Overdue Rate*" means, on any date of determination:

- (i) for the 2004 Series A Bonds, an interest rate per annum equal to the lesser of:
  - (A) 250% of the greater of
    - (1) One-Month LIBOR and
    - (2) AA Composite Commercial Paper Rate, or
  - (B) the Interest Rate Limitation.
- (ii) for the 2004 Series B Bonds, an interest rate per annum equal to the lesser of:
  - (A) 250% of the greater of
    - (1) the After-Tax Equivalent Rate and
    - (2) the Kenny Index, or
  - (B) the Interest Rate Limitation.

"*Participant*" means a member of, or participant in, the Securities Depository.

"*Payment Default*" means (i) a default by MHESO and the Credit Provider in the due and punctual payment of any installment of interest of any series of the Bonds or (ii) a default by MHESO and the Credit Provider in the due and punctual payment of the principal of any series of the Bonds whether at maturity or upon redemption or acceleration.

"*Quarterly Average Auction Rate*" shall mean the simple average of the Auction Rates for the Auction Dates preceding the current Auction Date by 91 days or less, including the current Auction Date.

"*Quarterly Average T-Bill Rate*" shall mean the simple average of the bond equivalent Yield of 91-day Treasury bills auctioned in the 91 days preceding (but not including) the current Auction Date.

"*Record Date*" shall mean, with respect to the Bonds, the Business Day prior to each Interest Payment Date during an Auction Rate Period and the fifteenth day before each before each Interest Payment Date during the Fixed Rate Period and, additionally, with respect to the 2004 Series B Bonds, any other date specified by a Conversion Supplement during any other Interest Period.

"*Reuters Screen LIBOR Page*" means the display designated as page "LIBOR" on the Reuters Monitor Money Rates Service (or such other page as may replace the LIBOR page for the purposes of displaying London interbank offered rates of major banks).

"*Securities Depository*" means The Depository Trust Company and its successors and assigns, or if (i) the Securities Depository resigns from its functions as depository of 2004 Series Bonds or (ii) MHESO, with the prior written consent of the Credit Provider, discontinues use of the Securities Depository, any other securities depository which agrees to follow the procedures required to be followed by a securities depository in connection with the Bonds and which is selected by MHESO with the consent of the Trustee, the Auction Agent and the Market Agent.

"*Sufficient Clearing Bids*" has the meaning set forth in Appendix III hereto, "AUCTION PROCEDURES – Procedures," and section (c)(i)(B) thereunder.

"*T-Bill Cap*" shall mean, for any Auction Date, the rate (for the then current auction) at which the Quarterly Average Auction Rate equals the Quarterly Average T-Bill Rate plus the Applicable Spread, such rate to be determined by the formula:

$$N \times (T + S) - R,$$

where N is the number of Auction Dates which precede the current Auction date by 91 days or less, including the current Auction Date; T is the Quarterly Average T-Bill Rate; S is the Applicable Spread; and R is the sum of the Auction Rates for Auction Dates preceding the current Auction Date by 91 days or less, excluding the current Auction.

"*Winning Bid Rate*" shall have the meaning set forth below in "AUCTION PROCEDURES – Procedures," and subparagraph (c)(i)(C) thereunder.

## **Procedures**

During any Auction Rate Period, Auctions shall be conducted on each Auction Date, if there is an Auction Agent on such Auction Date, in the following manner:

(a) *Orders By Existing Owners and Potential Owners.*

(i) Prior to the Submission Deadline on each Auction Date:

- (A) each Existing Owner of Bonds may submit to a Broker-Dealer by telephone or otherwise any information as to:
  - (1) the principal amount of outstanding Bonds, if any, owned by such Existing Owner which such Existing Owner desires to continue to own without regard to the Auction Rate for the next succeeding Auction Period;
  - (2) the principal amount of outstanding Bonds, if any, which such Existing Owner offers to sell if the Auction Rate for the next succeeding Auction Period shall be less than the rate per annum specified by such Existing Owner; and/or
  - (3) the principal amount of outstanding Bonds, if any, owned by such Existing Owner which such Existing Owner offers to sell without regard to the Auction Rate for the next succeeding Auction Period; and
- (B) one or more Broker-Dealers may contact Potential Owners to determine the principal amount of Bonds which each such Potential Owner offers to purchase, if the Auction Rate for the next

succeeding Auction Period shall not be less than the rate per annum specified by the such Potential Owner.

The statement of an Existing Owner or a Potential Owner referred to in clause (A) or (B) of this paragraph (i) is herein referred to as an "*Order*," and each Existing Owner and each Potential Owner placing an Order is hereinafter referred to as a "*Bidder*"; an Order described in clause (A)(1) is herein referred to as a "*Hold Order*"; an Order in clause (A)(2) or (B) is herein referred to as a "*Bid*"; and an Order described in clause (A)(3) is herein referred to as a "*Sell Order*".

- (ii) (A) Subject to the provisions of subsection (b) below, a Bid by an Existing Owner shall constitute an irrevocable offer to sell:
    - (1) the principal amount of outstanding Bonds specified in such Bid if the Auction Rate determined as provided in this Section shall be less than the rate specified therein; or
    - (2) such principal amount, or a lesser principal amount of outstanding Bonds to be determined as set forth in subsection (d)(i)(D) below, if the Auction Rate determined as provided in this Section shall be equal to the rate specified therein; or
    - (3) such principal amount, or a lesser principal amount of outstanding Bonds to be determined as set forth in subsection (d)(ii)(C) below, if the interest rate specified therein shall be higher than the Maximum Auction Rate and Sufficient Clearing Bids have not been made.
  - (B) Subject to the provisions of subsection (b) below, a Sell Order by an Existing Owner shall constitute an irrevocable offer to sell:
    - (1) the principal amount of outstanding Bonds specified in such Sell Order; or
    - (2) such principal amount, or a lesser principal amount of outstanding Bonds as set forth in subsection (d)(ii)(C) below, if Sufficient Clearing Bids have not been made.
  - (C) Subject to the provisions of subsection (b) below, a Bid by a Potential Owner shall constitute an irrevocable offer to purchase:
    - (1) the principal amount of outstanding Bonds specified in such Bid if the Auction Rate determined as provided in this Section shall be higher than the rate specified in such Bid; or
    - (2) such principal amount, or a lesser principal amount of outstanding Bonds as set forth in subsection (d)(i)(E) below, if the Auction Rate determined as provided in this Section shall be equal to the rate specified in such Bid.
- (b) *Submission by Broker-Dealers to the Auction Agent.*
- (i) Each Broker-Dealer shall submit in writing to the Auction Agent prior to the Submission Deadline on each Auction Date all Orders obtained by such Broker-Dealer and shall specify with respect to each such Order:
    - (A) the name of the Bidder placing such Order,
    - (B) the aggregate principal amount of Bonds that are the subject of such Order,



- (C) to the extent that such Bidder is an Existing Owner:
    - (1) the principal amount of Bonds, if any, subject to any Hold Order placed by such Existing Owner;
    - (2) the principal amount of Bonds, if any, subject to any Bid placed by such Existing Owner and the rate specified in such Bid; and
    - (3) the principal amount of Bonds, if any, subject to any Sell Order placed by such Existing Owner; and
  - (D) to the extent such Bidder is a Potential Owner, the rate and amount specified in such Potential Owner's Bid.
- (ii) A Broker-Dealer may submit orders in Auctions for its own account. Any Broker-Dealer submitting an order for its own account in any Auction will have an advantage over other bidders in that it will have knowledge of other orders placed through it in that Auction (but it will not have knowledge of orders submitted through other Broker-Dealers, if any). As a result of the Broker-Dealer bidding, the Auction clearing rate may be lower than the rate that would have prevailed if the Broker-Dealer had not bid. A Broker-Dealer may also bid or encourage additional or revised bidding in order to prevent what would otherwise be a failed Auction, an "all hold" Auction or an Auction clearing at a rate that the Broker-Dealer believes does not reflect the market rate for such securities at the time of the Auction.
  - (iii) If any rate specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent shall round such rate up to the next higher one-thousandth (.001) of 1%.
  - (iv) If an Order or Orders covering all outstanding Bonds owned by an Existing Owner is not submitted to the Auction Agent prior to the Submission Deadline, the Auction Agent shall deem a Hold Order to have been submitted on behalf of such Existing Owner covering the principal amount of outstanding Bonds owned by such Existing Owner and not subject to an Order submitted to the Auction Agent.
  - (v) None of MHESO, the Trustee nor the Auction Agent shall be responsible for any failure of a Broker-Dealer to submit an Order to the Auction Agent on behalf of any Existing Owner or Potential Owner.
  - (vi) If any Existing Owner submits through a Broker-Dealer to the Auction Agent one or more Orders covering in the aggregate more than the principal amount of outstanding Bonds owned by such Existing Owner, such Order shall be considered valid as follows and in the following order of priority:
    - (A) all Hold Orders shall be considered valid, but only up to and including the aggregate principal amount of outstanding Bonds owned by such Existing Owner, and if the aggregate principal amount of Bonds subject to such Hold Orders exceeds the aggregate principal amount of Bonds owned by such Existing Owner, the aggregate principal amount of Bonds subject to each such Hold Order shall be reduced pro rata so that the aggregate principal amount of Bonds subject to such Hold Order equals the aggregate principal amount of outstanding Bonds owned by such Existing Owner.
    - (B) (1) any Bid shall be considered valid up to and including an amount equal to the excess of the principal amount of outstanding Bonds owned by such Existing Owner over the aggregate principal amount of Bonds subject to any Hold Order referred to in clause (A) of this paragraph (v);

- (2) subject to subclause (1) of this clause (B), if more than one Bid with the same rate is submitted on behalf of such Existing Owner and the aggregate principal amount of outstanding Bonds subject to such Bids is greater than such excess, such Bids shall be considered valid up to and including the amount of such excess, and the principal amount of outstanding Bonds subject to each Bid with the same rate shall be reduced pro rata so that the aggregate principal amount of outstanding Bonds subject to such Bids is equal to such excess;
    - (3) subject to subclauses (1) and (2) of this clause (B), if more than one Bid with different rates is submitted on behalf of such Existing Owner, such Bids shall be considered valid first in the ascending order of their respective rates until the highest rate is reached at which such excess exists and then at such rate up to and including the amount of such excess; and
    - (4) in any such event, the aggregate principal amount of outstanding Bonds, if any, subject to Bids not valid under this clause (B) shall be treated as the subject of a Bid by a Potential Owner at the rate therein specified; and
  - (C) all Sell Orders shall be considered valid up to and including an amount equal to the excess of the principal amount of outstanding Bonds owned by such Existing Owner over the aggregate principal amount of outstanding Bonds subject to Hold Orders referred to in clause (A) of this paragraph (v) and valid Bids referred to in clause (B) of this paragraph (v).
  - (vii) If more than one Bid for Bonds is submitted on behalf of any Potential Owner, each Bid submitted shall be a separate Bid with the rate and principal amount therein specified.
  - (viii) An Existing Owner that offers to purchase additional Bonds is, for purposes of such offer, treated as a Potential Owner.
  - (ix) Any Bid or Sell Order submitted by an Existing Owner covering an aggregate principal amount of Bonds not equal to an Authorized Denomination shall be rejected and shall be deemed a Hold Order. Any Bid submitted by a Potential Owner covering an aggregate principal amount of Bonds not equal to an Authorized Denomination shall be rejected.
  - (x) Any Bid specifying a rate higher than the Maximum Auction Rate will
    - (A) be treated as a Sell Order if submitted by an Existing Owner and
    - (B) not be accepted if submitted by a Potential Owner.
  - (xi) Any Bid submitted by an Existing Owner or a Potential Owner specifying a rate lower than the All Hold Rate shall be treated as a bid specifying the All Hold Rate and any such bid shall be considered as valid and shall be selected in the ascending order of their respective rates in the Submitted Bids.
  - (xii) Any Order submitted in an Auction by a Broker-Dealer to the Auction Agent before the Submission Deadline on any Auction Date shall be irrevocable.
- (c) *Determination of Sufficient Clearing Bids, Auction Rate and Winning Bid Rate.*
- (i) Not earlier than the Submission Deadline on each Auction Date, the Auction Agent shall assemble all valid Orders submitted or deemed submitted to it by the Broker-Dealers (each such Order as submitted or deemed submitted by a Broker-Dealer being hereinafter referred to individually as a "Submitted Hold Order," a "Submitted Bid" or "Submitted Sell Order," as the case may be, or as a "Submitted Order," and collectively as "Submitted Hold Orders," "Submitted Bids" or "Submitted Sell Orders," as the case may be, or as "Submitted Orders") and shall determine:

- (A) the excess of the total principal amount of outstanding Bonds over the sum of the aggregate principal amount of outstanding Bonds subject to Submitted Hold Orders (such excess being herein referred to as the "*Available Bonds*"); and
- (B) from such Submitted Orders whether
  - (1) the aggregate principal amount of outstanding Bonds subject to Submitted Bids by Potential Owners specifying one or more rates equal to or lower than the Maximum Auction Rate;
 

exceeds or is equal to the sum of:

    - (2) the aggregate principal amount of outstanding Bonds subject to the Submitted Bids by Existing Owners specifying one or more rates higher than the Maximum Auction Rate; and
    - (3) the aggregate principal amount of outstanding Bonds subject to Submitted Sell Orders;

(in the event such excess or such equality exists, other than because all of the outstanding Bonds are subject to Submitted Hold Orders, such Submitted Bids in subclause (1) above being herein referred to collectively as "*Sufficient Clearing Bids*"); and
  - (C) if Sufficient Clearing Bids exist, the "*Winning Bid Rate*," which shall be the lowest rate specified in such Submitted Bids such that if:
    - (1) each Submitted Bid from Existing Owners specifying such lowest rate and all other Submitted Bids from Existing Owners specifying lower rates were rejected, thus entitling such Existing Owners to continue to own the principal amount of Bonds subject to such Submitted Bids; and
    - (2) each such Submitted Bid from Potential Owners specifying such lowest rate and all other Submitted Bids from Potential Owners specifying lower rates were accepted,

the result would be that such Existing Owners described in subclause (1) above would continue to hold an aggregate principal amount of outstanding Bonds which, when added to the aggregate principal amount of outstanding Bonds to be purchased by such Potential Owners described in subclause (2) above, would equal not less than the Available Bonds.
- (ii) Promptly after the Auction Agent has made the determinations pursuant to subsection (c)(i) of this Section, the Auction Agent shall determine the Auction Rate for the next succeeding Auction Period as follows:
  - (A) if Sufficient Clearing Bids exist, that the Auction Rate for the next succeeding Auction Period shall be equal to the Winning Bid Rate so determined;
  - (B) if Sufficient Clearing Bids do not exist (other than because of all the outstanding Bonds are subject to Submitted Hold Orders), that the Auction Rate for the next succeeding Auction Period shall be equal to the Maximum Auction Rate; or
  - (C) if all Outstanding Bonds are subject to Submitted Hold Orders, that the Auction Rate for the next succeeding Auction Period shall be equal to the All Hold Rate.
- (iii) Promptly after the Auction Agent has determined the Auction Rate, the Auction Agent shall determine and advise the Trustee of the Bond Interest Rate, which rate shall be the Auction Rate;

provided, however, that in no event shall the Bond Interest Rate exceed the Maximum Auction Rate, subject to the Interest Rate Limitation.

- (d) *Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Bonds.* Existing Owners shall continue to hold the principal amount of Bonds that are subject to Submitted Hold Orders and, based on determinations made pursuant to paragraph (i) of subsection (c) of this Section, Submitted Bids and Submitted Sell Orders shall be accepted or rejected and the Auction Agent shall take such other action as set forth below:
- (i) If Sufficient Clearing Bids have been made and the Maximum Auction Rate is equal to or greater than the Winning Bid Rate (in which case the Bond Interest Rate shall be the Winning Bid Rate), all Submitted Sell Orders shall be accepted and, subject to the provisions of paragraphs (iv) and (v) of this subsection (d), Submitted Bids shall be accepted or rejected as follows in the following order of priority, and all other Submitted Bids shall be rejected:
- (A) Existing Owners' Submitted Bids specifying any rate that is higher than the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to sell the aggregate principal amount of Bonds subject to such Submitted Bids;
- (B) Existing Owners' Submitted Bids specifying any rate that is lower than the Winning Bid Rate shall be rejected, thus entitling each such Existing Owner to continue to own the aggregate principal amount of Bonds subject to such Submitted Bids;
- (C) Potential Owners' Submitted Bids specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring such Potential Owners to purchase the aggregate principal amount of Bonds subject to such Submitted Bids;
- (D) Each Existing Owners' Submitted Bid specifying a rate that is equal to the Winning Bid Rate shall be rejected, thus entitling such Existing Owner to continue to own the aggregate principal amount of Bonds subject to such Submitted Bid, unless the aggregate principal amount of outstanding Bonds subject to all such Submitted Bids shall be greater than the principal amount of Bonds (the "*remaining principal amount*") equal to the excess of the Available Bonds over the aggregate principal amount of Bonds subject to Submitted Bids described in clauses (B) and (C) of this paragraph (d)(i), in which event such Submitted Bid of such Existing Owner shall be rejected in part, and such Existing Owner shall be entitled to continue to own the principal amount of Bonds subject to such Submitted Bid, but only in an amount equal to the aggregate principal amount of Bonds obtained by multiplying the remaining principal amount by a fraction the numerator of which shall be the principal amount of outstanding Bonds owned by such Existing Owner subject to such Submitted Bid and the denominator of which shall be the sum of the principal amount of outstanding Bonds subject to such Submitted Bids made by all such Existing Owners that specified a rate equal to the Winning Bid Rate; and
- (E) Each Potential Owner's Submitted Bid specifying a rate that is equal to the Winning Bid Rate shall be accepted, but only in an amount equal to the principal amount of Bonds obtained by multiplying the excess of the aggregate principal amount of Available Bonds over the aggregate principal amount of Available Bonds subject to Submitted Bids described in clauses (B), (C) and (D) of this paragraph (d)(i) by a fraction the numerator of which shall be the aggregate principal amount of outstanding Bonds subject to such Submitted Bid and the denominator of which shall be the sum of the principal amounts of outstanding Bonds subject to Submitted Bids made by all such Potential Owners that specified a rate equal to the Winning Bid Rate.
- (ii) If Sufficient Clearing Bids have not been made (other than because all of the outstanding Bonds are subject to Submitted Hold Orders), or if the Maximum Auction Rate is less than the Winning Bid

Rate (in which case the Bond Interest Rate shall be Maximum Auction Rate), or if the Interest Rate Limitation applies, subject to the provisions of paragraphs (iv) and (v) of this subsection (d), Submitted Orders shall be accepted or rejected as follows in the following order of priority and all other Submitted Bids shall be rejected:

- (A) Existing Owners' Submitted Bids specifying any rate that is equal to or lower than the Maximum Auction Rate shall be rejected, thus entitling such Existing Owners to continue to hold the aggregate principal amount of Bonds subject to such Submitted Bids;
  - (B) Potential Owners' Submitted Bids specifying (1) any rate that is equal to or lower than the Maximum Auction Rate shall be accepted, thus requiring each Potential Owner to purchase the aggregate principal amount of Bonds subject to such Submitted Bids; and (2) any rate that is higher than the Maximum Auction Rate shall be rejected; and
  - (C) Each Existing Owner's Submitted Bid specifying any rate that is higher than the Maximum Auction Rate and the Submitted Sell Order of each Existing Owner shall be accepted, thus entitling each Existing Owner that submitted any such Submitted Bid or Submitted Sell Order to sell the Bonds subject to such Submitted Bid or Submitted Sell Order, but in both cases only in an amount equal to the aggregate principal amount of Bonds obtained by multiplying the aggregate principal amount of Bonds subject to Submitted Bids described in clause (B)(1) of this paragraph (d)(ii) by a fraction the numerator of which shall be the aggregate principal amount of outstanding Bonds owned by such Existing Owner subject to such Submitted Bid or Submitted Sell Order and the denominator of which shall be the aggregate principal amount of outstanding Bonds subject to all such Submitted Bids and Submitted Sell Orders.
- (iii) If all outstanding Bonds are subject to Submitted Hold Orders, all Submitted Bids shall be rejected.
  - (iv) If, as a result of the procedures described in paragraph (i) or (ii) of this subsection (d), any Existing Owner would be entitled or required to sell, or any Potential Owner would be entitled or required to purchase, a principal amount of Bonds that is not equal to an Authorized Denomination the Auction Agent shall, in such manner as in its sole discretion shall determine, round up or down the principal amount of Bonds to be purchased or sold by any Existing Owner or Potential Owner so that the principal amount of Bonds purchased or sold by each Existing Owner or Potential Owner shall be equal to an Authorized Denomination, even if such allocation results in one or more of such Potential Owners not purchasing any Bonds.
  - (v) If, as a result of the procedures described in paragraph (i) or (ii) of this subsection (d), any Potential Owner would be entitled or required to purchase less than an Authorized Denomination of Bonds, the Auction Agent shall, in such manner as in its sole discretion it shall determine, allocate Bonds for purchase among Potential Owners so that only Bonds in Authorized Denominations are purchased by any Potential Owner, even if such allocation results in one or more of such Potential Owners not purchasing any Bonds.
- (e) Based on the results of each Auction, the Auction Agent shall determine the aggregate principal amount of Bonds to be purchased and the aggregate principal amount of Bonds to be sold by Potential Owners and Existing Owners on whose behalf each Broker-Dealer submitted Bids or Sell Orders and, with respect to each Broker-Dealer, to the extent that such aggregate principal amount of Bonds to be sold differs from such aggregate principal amount of Bonds to be purchased, determine to which other Broker-Dealer or Broker-Dealers acting for one or more purchasers such Broker-Dealer shall deliver, or from which other Broker-Dealer or Broker-Dealers acting for one or more sellers such Broker-Dealer shall receive, as the case may be, Bonds.
  - (f) Any calculation by the Auction Agent or the Trustee, as applicable, of the Bond Interest Rate, Maximum Auction Rate, All Hold Rate and Overdue Rate shall, in the absence of manifest error, be binding on all other parties.

- (g) Notwithstanding anything to the contrary, if any Bonds or portion thereof have been selected for redemption during the next succeeding Interest Period, such Bonds or portion thereof will not be included in the Auction preceding such Redemption Date, and will continue to bear interest until the Redemption Date at the rate established for the Interest Period prior to said Auction.

**APPENDIX IV**

**SETTLEMENT PROCEDURES**

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## SETTLEMENT PROCEDURES

Capitalized terms used herein shall have the respective meanings specified in the Indenture.

- (a) Not later than 3:00 p.m. on each Auction Date, the Auction Agent is required to notify by telephone the Broker-Dealers that participated in the Auction held on such Auction Date and submitted an Order on behalf of any Existing Owner or Potential Owner of:
  - (i) the Auction Rate fixed for the next succeeding Interest Period;
  - (ii) whether Sufficient Bids existed for the determination of the Auction Rate;
  - (iii) if such Broker-Dealer submitted a Bid or a Sell Order on behalf of an Existing Owner, whether such Bid or Sell Order was accepted or rejected, in whole or in part, and the principal amount of Bonds, if any, to be sold by such Existing Owner;
  - (iv) if such Broker-Dealer submitted a Bid on behalf of a Potential Owner, whether such Bid was accepted or rejected, in whole or in part, and the principal amount of Bonds, if any, to be purchased by such Potential Owner;
  - (v) if the aggregate principal amount of Bonds to be sold by all Existing Owners on whose behalf such Broker-Dealer submitted Bids or Sell Orders is different than the aggregate principal amount of Bonds to be purchased by all Potential Owners on whose behalf such Broker-Dealer submitted a Bid, the name or names of one or more other Broker-Dealers (and the Participant, if any, of each such other Broker-Dealer) and the principal amount of Bonds to be purchased from one or more Existing Owners on whose behalf such other Broker-Dealers acted by one or more Potential Owners on whose behalf each of such other Buyer's Broker-Dealers acted;
  - (vi) if the principal amount of Bonds to be purchased by all Potential Owners on whose behalf such Broker-Dealer submitted a Bid exceeds the amount of Bonds to be sold by all Existing Owners on whose behalf such Broker-Dealer submitted a Bid or a Sell Order, the name or names of one or more Seller's Broker-Dealers (and the name of the Participant, if any, of each such Seller's Broker-Dealer) acting for one or more sellers of such excess principal amount of Bonds and the principal amount of Bonds to be sold to one or more Potential Owners on whose behalf such Broker-Dealer acted by one or more Existing Owners on whose behalf each of such Seller's Broker-Dealers acted;
  - (vii) unless previously provided, a list of all Applicable RAMS Rates and related Interest Periods (or portions thereof) since the last Interest Payment Date; and
  - (viii) the scheduled Auction Date of the next succeeding Auction.
- (b) On each Auction Date, each Broker-Dealer that submitted an Order on behalf of any Existing Owner or Potential Owner is required to:
  - (i) advise each Existing Owner and Potential Owner on whose behalf such Broker-Dealer submitted a Bid or Sell Order whether such Bid or Sell Order was accepted or rejected, in whole or in part;
  - (ii) instruct each Potential Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole or in part, to instruct such Bidder's Participant to pay to such Broker-Dealer (or its Participant) through the Securities Depository the amount necessary, including accrued interest, if any, to purchase the principal amount of Bonds to be purchased pursuant to such Bid against receipt of such principal amount of Bonds;

- (iii) in the case of a Broker-Dealer that is a Seller's Broker-Dealer, instruct each Existing Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole in part, or a Sell Order that was accepted, in whole or in part, to instruct such Bidder's Participant to deliver to such Broker-Dealer (or its Participant) through the Securities Depository the principal amount of Bonds to be sold pursuant to such Bid or Sell Order against payment therefor;
  - (iv) advise each Existing Owner on whose behalf such Broker-Dealer submitted an Order and each Potential Owner on whose behalf such Broker-Dealer submitted a Bid of the Auction Rate for the next succeeding Auction Period;
  - (v) advise each Existing Owner on whose behalf such Broker-Dealer submitted an Order of the scheduled Auction Date of the next succeeding Auction; and
  - (vi) advise each Potential Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole or in part, of the Auction Date of the next succeeding Auction.
- (c) On the basis of the information provided to it pursuant to paragraph (a) above, each Broker-Dealer that submitted a Bid or Sell Order is required to allocate any funds received by it pursuant to paragraph (b)(ii) above, and any Bonds received by it pursuant to paragraph (b)(iii) above, among the Potential Owners, if any, on whose behalf such Broker-Dealer submitted Bids, the Existing Owners, if any, on whose behalf such Broker-Dealer submitted Bids, the Existing Owners, if any, on whose behalf such Broker-Dealer submitted Bids or Sell Orders, and any Broker-Dealers identified to it by the Auction Agent pursuant to paragraph (a)(v) or (a)(vi) above.
- (d) On each Auction Date:
  - (i) each Potential Owner and Existing Owner with an Order in the Auction on such Auction Date shall instruct its Participant as provided in (b)(ii) or (b)(iii) above, as the case may be;
  - (ii) each Seller's Broker-Dealer that is not a Participant in a Securities Depository instruct its Participant to (A) pay through the Securities Depository to the Participant of the Existing Owner delivering Bonds to such Broker-Dealer following such Auction pursuant to (b)(iii) above the amount necessary, including accrued interest, if any, to purchase such Bonds against receipt of such 2004 Series Bonds, and (B) deliver such Bonds through the Securities Depository to a Buyer's Broker-Dealer (or its Participant) identified to such Seller's Broker-Dealer pursuant to (a)(v) above against payment therefor; and
  - (iii) each Buyer's Broker-Dealer that is not a Participant shall instruct its Participant to (A) pay through the Securities Depository to a Seller's Broker-Dealer (or its Participant) identified following such Auction pursuant to (a)(vi) above the amount necessary, including accrued interest, if any, to purchase the Bonds to be purchased pursuant to (b)(ii) above against receipt of such Bonds, and (B) deliver such Bonds through the Securities Depository to the Participant of the purchaser thereof against payment therefor.
- (e) On the first Business Day of the Interest Period succeeding each Auction Date:
  - (i) each Participant for a Bidder in the Auction on such Auction Date referred to in (d)(i) above shall instruct the Securities Depository to execute the transactions described under (b)(ii) or (b)(iii) above for such Auction, and the Securities Depository shall execute such transactions;
  - (ii) each Seller's Broker-Dealer or its Participant shall instruct the Securities Depository to execute the transactions described in (d)(ii) above for such Auction, and the Securities Depository shall execute such transactions; and

- (iii) each Buyer's Broker-Dealer or its Participant shall instruct the Securities Depository to execute the transactions described in (d)(iii) above for such Auction, and the Securities Depository shall execute such transactions.
- (f) If an Existing Owner selling Bonds in an Auction fails to deliver such Bonds (by authorized book-entry), a Broker-Dealer may deliver to the Potential Owner on behalf of which it submitted a Bid that was accepted a principal amount of Bonds that is less than the principal amount of Bonds that otherwise was to be purchased by such Potential Owner. In such event, the principal amount of Bonds to be so delivered shall be determined solely by such Broker-Dealer. Delivery of such lesser principal amount of Bonds shall constitute good delivery. Notwithstanding the foregoing terms of this paragraph (f), any delivery or nondelivery of Bonds which shall represent any departure from the results of an Auction, as determined by the Auction Agent, shall be of no effect unless and until the Auction Agent shall have been notified of such delivery or nondelivery in accordance with the provisions of the Auction Agent and the Broker-Dealer Agreement.

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**APPENDIX V**

**FORM OF OPINIONS**

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July 29, 2004

RBC Dain Rauscher Inc.  
60 South 6<sup>th</sup> Street  
Minneapolis, Minnesota 55402

MBIA Insurance Corporation  
113 King Street  
Armonk, New York, 10504

Moody's Investors Service, Inc.  
99 Church Street  
New York, New York 10007

Fitch Ratings  
1 State Street Plaza  
New York, New York 10004

RE: \$67,000,000 Minnesota Higher Education Services Office  
Supplemental Student Loan Program Revenue Bonds, 2004 Series A (Taxable)

Ladies and Gentlemen:

We have acted as Bond Counsel to Minnesota Higher Education Services Office, an agency of the State of Minnesota (the "Issuer"), in connection with the issuance of \$67,000,000 aggregate principal amount of the Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds, 2004 Series A (Taxable) (the "Series 2004A Bonds"). We are providing this opinion to you pursuant to Paragraph 8(e)(iii) of the Bond Purchase Agreement, dated July 27, 2004 (the "Bond Purchase Agreement"), between the Issuer and RBC Dain Rauscher Inc. The capitalized terms used and not defined herein are defined in the Bond Purchase Agreement or in the General Indenture, dated as of November 1, 1999 (the "General Indenture"), as supplemented and amended by the Sixth Supplemental Indenture, dated as of July 1, 2004 (the "Sixth Supplemental Indenture")(collectively, the "Indenture"), between the Issuer and Wells Fargo Bank, National Association, as trustee, and pursuant to which the Series 2004A Bonds are being issued.

We have examined such documents and have reviewed such questions of law as we have considered necessary and appropriate for the purposes of our opinions set forth below.

Our opinions expressed in paragraphs (6) and (7) below as to certain factual matters are qualified as being limited "to our knowledge" or by other words to the same or similar effect. Such words, as used herein, mean the information known to Morris Knopf and Jill Laorr, the attorneys who have represented the Issuer in connection with the transactions contemplated by the Bond Purchase Agreement. In rendering such opinions, he has not conducted any independent investigation or consulted with other attorneys in our firm with respect to the matters covered thereby. No inference as to our knowledge with respect to such matters should be drawn from the fact of our representation of the Issuer.

In rendering our opinions set forth below, we have assumed the authenticity of all documents submitted to us as originals, the genuineness of all signatures and the conformity to

authentic originals of all documents submitted to us as copies. We have also assumed the legal capacity for all purposes relevant hereto of all natural persons and, with respect to all parties to agreements or instruments relevant hereto other than the Issuer, that such parties had the requisite power and authority (corporate or otherwise) to execute, deliver and perform such agreements or instruments, that such agreements or instruments have been duly authorized by all requisite action (corporate or otherwise) executed and delivered by such parties, and that such agreements or instruments are the valid, binding and enforceable obligations of such parties. As to questions of fact material to our opinions, we have relied upon the representations made in the Bond Purchase Agreement and upon certificates of officers of the Issuer and of public officials (including, without limitation, those certificates delivered to others at the Closing). Finally, we take no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Series 2004A Bonds and express no opinion with respect thereto except as expressed in paragraphs (7) and (8) below.

Based on the foregoing, we are of the opinion that:

(1) The Issuer is an agency of the State of Minnesota and is validly existing under the laws of the State of Minnesota.

(2) The Issuer has full right, power and authority to enter into, execute, deliver and perform its obligations under the Series 2004A Bonds, the Bond Purchase Agreement, the Sixth Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004A Reimbursement and Indemnity Agreement and the Series 2004A Auction Agency Agreement.

(3) The execution, delivery and performance of the Series 2004A Bonds, the Bond Purchase Agreement, the Sixth Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004A Reimbursement and Indemnity Agreement and the Series 2004A Auction Agency Agreement, for and in the name of the Issuer, have been duly authorized by all necessary action on the part of the Issuer.

(4) The Series 2004A Bonds, the Bond Purchase Agreement, the Sixth Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004A Reimbursement and Indemnity Agreement and the Series 2004A Auction Agency Agreement have been duly authorized, executed and delivered on behalf of the Issuer by the Director and are valid and binding obligations of the Issuer enforceable in accordance with their terms.

(5) All consents, approvals, licenses or exemptions of, or any filings or registrations with, any federal or state regulatory agency required at the date hereof in connection with the Issuer's execution, delivery and performance of the Series 2004A Bonds, the Bond Purchase Agreement, the Sixth Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004A Reimbursement and Indemnity Agreement and the Series 2004A Auction Agency Agreement have been obtained; provided that no opinion is expressed as to the registration requirements of the securities or "Blue Sky" laws of any state.



(6) The execution and delivery by the Issuer of the Series 2004A Bonds, the Bond Purchase Agreement, the Sixth Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004A Reimbursement and Indemnity Agreement and the Series 2004A Auction Agency Agreement will not, to the best of our knowledge, conflict with, violate or constitute a breach of or default under any indenture or other agreement known to us to which the Issuer is a party or by which the Issuer is bound, or, to the best of our knowledge, any applicable law, administrative regulation, order or court decree.

(7) To the best of our knowledge, there is no action, suit or proceeding, before or by any court against the Issuer, wherein an unfavorable decision, ruling or finding would materially adversely affect the validity or enforceability of the Series 2004A Bonds, the Bond Purchase Agreement, the Sixth Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004A Reimbursement and Indemnity Agreement and the Series 2004A Auction Agency Agreement.

(8) Interest on the Series 2004A Bonds is not excludable from the “gross income” of the owners thereof for federal income tax purposes.

The opinions set forth above are subject to the following qualifications and exceptions:

(a) Our opinion in paragraph (4) above is subject to the effect of any applicable bankruptcy, insolvency, reorganization, moratorium or other similar law of general application affecting creditors’ or secured creditors’ rights.

(b) Our opinion in paragraph (4) above is subject to the effect of general principles of equity, including (without limitation) concepts of materiality, reasonableness, good faith and fair dealing, and other similar doctrines affecting the enforceability of agreements generally (regardless of whether considered in a proceeding in equity or at law).

(c) Our opinion in paragraph (4) above, insofar as it relates to indemnification provisions, is subject to the effect of federal and state securities laws and public policy relating thereto.

Our opinions expressed above are limited to the law of the State of Minnesota and the federal laws of the United States of America, and we assume no responsibility as to the applicability to this transaction, or the effect thereon, of the laws of any other jurisdiction. This opinion is rendered as of the date set forth above and is based upon laws, regulations, rulings and decisions in effect on such date, and we express no opinion as to circumstances or events which may occur subsequent to such date.

Respectfully submitted,

BEST & FLANAGAN LLP

July 29, 2004

RBC Dain Rauscher Inc.  
60 South 6<sup>th</sup> Street  
Minneapolis, Minnesota 55402

MBIA Insurance Corporation  
113 King Street  
Armonk, New York, 10504

Moody's Investors Service, Inc.  
99 Church Street  
New York, New York 10007

Fitch Ratings  
1 State Street Plaza  
New York, New York 10004

RE: \$88,500,000 Minnesota Higher Education Services Office  
Supplemental Student Loan Program Revenue Bonds, 2004 Series B (Tax-Exempt)

Ladies and Gentlemen:

We have acted as Bond Counsel to Minnesota Higher Education Services Office, an agency of the State of Minnesota (the "Issuer"), in connection with the issuance of \$88,500,000 aggregate principal amount of the Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds, 2004 Series B (Tax Exempt) (the "Series 2004B Bonds"). We are providing this opinion to you pursuant to Paragraph 8(e)(iii) of the Bond Purchase Agreement, dated July 27, 2004 (the "Bond Purchase Agreement"), between the Issuer and RBC Dain Rauscher Inc. The capitalized terms used and not defined herein are defined in the Bond Purchase Agreement or in the General Indenture, dated as of November 1, 1999 (the "General Indenture"), as supplemented and amended by a Seventh Supplemental Indenture, dated as of July 1, 2004 (the "Seventh Supplemental Indenture")(collectively, the "Indenture"), between the Issuer and Wells Fargo Bank, National Association, as trustee, and pursuant to which the Series 2004B Bonds are being issued.

We have examined such documents and have reviewed such questions of law as we have considered necessary and appropriate for the purposes of our opinions set forth below.

Our opinions expressed in paragraphs (6) and (7) below as to certain factual matters are qualified as being limited "to our knowledge" or by other words to the same or similar effect. Such words, as used herein, mean the information known to Morris Knopf and Jill Laorr, the attorneys who have represented the Issuer in connection with the transactions contemplated by the Bond Purchase Agreement. In rendering such opinions, she has not conducted any independent investigation or consulted with other attorneys in our firm with respect to the matters covered thereby. No inference as to our knowledge with respect to such matters should be drawn from the fact of our representation of the Issuer.

In rendering our opinions set forth below, we have assumed the authenticity of all documents submitted to us as originals, the genuineness of all signatures and the conformity to authentic originals of all documents submitted to us as copies. We have also assumed the legal capacity for all purposes relevant hereto of all natural persons and, with respect to all parties to

agreements or instruments relevant hereto other than the Issuer, that such parties had the requisite power and authority (corporate or otherwise) to execute, deliver and perform such agreements or instruments, that such agreements or instruments have been duly authorized by all requisite action (corporate or otherwise) executed and delivered by such parties, and that such agreements or instruments are the valid, binding and enforceable obligations of such parties. As to questions of fact material to our opinions, we have relied upon the representations made in the Bond Purchase Agreement and upon certificates of officers of the Issuer and of public officials (including, without limitation, those certificates delivered to others at the Closing). Finally, we take no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Series 2004B Bonds and express no opinion with respect thereto except as expressed in paragraphs (7) and (8) below.

Based on the foregoing, we are of the opinion that:

(1) The Issuer is an agency of the State of Minnesota (the “State”) and is validly existing under the laws of the State.

(2) The Issuer has full right, power and authority to enter into, execute, deliver and perform its obligations under the Series 2004B Bonds, the Bond Purchase Agreement, the Seventh Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004B Reimbursement and Indemnity Agreement and the Series 2004B Auction Agency Agreement.

(3) The execution, delivery and performance of the Series 2004B Bonds, the Bond Purchase Agreement, the Seventh Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004B Reimbursement and Indemnity Agreement and the Series 2004B Auction Agency Agreement, for and in the name of the Issuer, have been duly authorized by all necessary action on the part of the Issuer.

(4) The Series 2004B Bonds, the Bond Purchase Agreement, the Seventh Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004B Reimbursement and Indemnity Agreement and the Series 2004B Auction Agency Agreement have been duly authorized, executed and delivered on behalf of the Issuer by the Director and are valid and binding obligations of the Issuer enforceable in accordance with their terms.

(5) All consents, approvals, licenses or exemptions of, or any filings or registrations with, any federal or state regulatory agency required at the date hereof in connection with the Issuer’s execution, delivery and performance of the Series 2004B Bonds, the Bond Purchase Agreement, the Seventh Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004B Reimbursement and Indemnity Agreement and the Series 2004B Auction Agency Agreement have been obtained; provided that no opinion is expressed as to the registration requirements of the securities or “Blue Sky” laws of any state.

(6) The execution and delivery by the Issuer of the Series 2004B Bonds, the Bond Purchase Agreement, the Seventh Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004B Reimbursement and Indemnity Agreement and the Series 2004B

Auction Agency Agreement will not, to the best of our knowledge, conflict with, violate or constitute a breach of or default under any indenture or other agreement known to us to which the Issuer is a party or by which the Issuer is bound, or, to the best of our knowledge, any applicable law, administrative regulation, order or court decree.

(7) To the best of our knowledge, there is no action, suit or proceeding, before or by any court against the Issuer, wherein an unfavorable decision, ruling or finding would materially adversely affect the validity or enforceability of the Series 2004B Bonds, the Bond Purchase Agreement, the Seventh Supplemental Indenture, the Continuing Disclosure Agreement, the Series 2004B Reimbursement and Indemnity Agreement and the Series 2004B Auction Agency Agreement.

(8) Interest on the 2004B Bonds is excluded from gross income for Federal income taxes. Interest on the 2004B Bonds is an item of tax preference for purposes of the Federal alternative minimum tax imposed on individuals and corporations. The exemption from gross income under the Code may become inapplicable with respect to the Series 2004B Bonds, as of either the date of issuance of Series 2004B Bonds or on a later date, upon the occurrence of certain subsequent events, including, without limitation, (1) the proceeds of the 2004B Bonds being expended in a manner or for a use inconsistent with certain applicable requirements of Sections 141 and 144 of the Code or (2) the investment of amounts in “nonpurpose obligations” (as defined in Section 148 of the Code) or the application of the earnings of investments in said “nonpurpose obligations,” in each case, in a manner contrary to the requirements of Section 148 of the Code. In addition to the foregoing exceptions, the opinion set forth in the first sentence of this paragraph is subject to the condition that the Issuer and the Trustee comply with all requirements of the Code that must be satisfied subsequent to the issuance of the Series 2004B Bonds in order that interest thereon be, or continue to be, excluded from gross income for Federal income tax purposes. The Issuer and the Trustee have covenanted to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of interest on the Series 2004B Bonds in gross income for Federal income tax purposes to be retroactive to the date of issuance of the Series 2004B Bonds. No opinion is expressed regarding other Federal tax consequences arising with respect to the Series 2004B Bonds. The Series 2004B Bonds are not “arbitrage bonds” within the meaning of Section 148 of the Code. Interest on the Series 2004B Bonds is an item of tax preference required to be included in the computation of alternative minimum taxable income for purposes of the federal and Minnesota alternative minimum taxes.

(9) Interest on the Series 2004B Bonds is not includible in gross income for the purpose of State income taxes, except for State corporate and bank excise taxes measured by income.

The opinions expressed in paragraphs (8) and (9) above are subject to the condition of compliance by the Issuer with all requirements of the Code that must be satisfied subsequent to the issuance of the Series 2004B Bonds in order that interest thereon may be, and continue to be, excluded from gross income for federal income tax purposes and taxable net income for Minnesota income tax purposes. Noncompliance with such requirements could result in the

inclusion of interest on the Series 2004B Bonds in gross income for federal income tax purposes and taxable net income of individuals, estates and trusts for Minnesota income tax purposes, retroactive to the date of issuance of the Series 2004B Bonds. The Indenture contains provisions which, if complied with, will satisfy such requirements. In expressing the opinions in paragraph (4), we have assumed compliance by the Issuer and the Trustee with the provisions of the Indenture. Except as stated in this opinion, we express no opinion regarding federal, state or other tax consequences to owners of the Series 2004B Bonds.

The opinions set forth above are subject to the following qualifications and exceptions:

(a) Our opinion in paragraph (4) above is subject to the effect of any applicable bankruptcy, insolvency, reorganization, moratorium or other similar law of general application affecting creditors' or secured creditors' rights.

(b) Our opinion in paragraph (4) above is subject to the effect of general principles of equity, including (without limitation) concepts of materiality, reasonableness, good faith and fair dealing, and other similar doctrines affecting the enforceability of agreements generally (regardless of whether considered in a proceeding in equity or at law).

(c) Our opinion in paragraph (4) above, insofar as it relates to indemnification provisions, is subject to the effect of federal and state securities laws and public policy relating thereto.

Our opinions expressed above are limited to the laws of the State of Minnesota and the federal laws of the United States of America, and we assume no responsibility as to the applicability to this transaction, or the effect thereon, of the laws of any other jurisdiction. This opinion is rendered as of the date set forth above and is based upon laws, regulations, rulings and decisions in effect on such date, and we express no opinion as to circumstances or events which may occur subsequent to such date.

Respectfully submitted,

BEST & FLANAGAN LLP

**APPENDIX VI**

**LOAN PORTFOLIO COMPOSITION**

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## LOAN PORTFOLIO COMPOSITION

The following tables illustrate certain characteristics of the loan portfolio existing under the Indenture as of May 31, 2004, adjusted to include the loan portfolio that is expected to be refinanced with the proceeds of the 2004 Series Bonds. See "SOURCES AND USES OF FUNDS" herein.

### General Loan Portfolio Information as of May 31, 2004.

Total principal amount of SELF loans outstanding:	\$225,596,496
Number of borrowers:	52,504
SELF II interest rate <sup>1</sup> :	3.00%
SELF III interest rate <sup>2</sup> :	4.60%
Average loan balance:	\$2,680

<u>School Type</u>	<u>\$ Amount</u>	<u>% of Total</u>
4 Year, Graduate and Professional	\$180,677,411	80.1%
2 Year	37,792,547	16.8%
Vocational	6,317,116	2.8%
Non-Classified	809,421	0.4%
Total	\$225,596,496	100.0%

<u>Loan Status</u>	<u>\$ Amount</u>	<u>% of Total</u>
School	\$54,822,961	24.3%
Grace	32,527,762	14.4%
Extended Grace	22,417,067	9.9%
Forbearance	134,394	0.1%
Repayment	114,984,503	51.0%
Claim	709,809	0.3%
Total	\$225,596,496	100.0%

*It is expected that recycling of loan receipts will take place according to the provisions of the Indenture. Either SELF II or SELF III loans may be originated or otherwise acquired from recycling receipts.*

<sup>1</sup> SELF II loan interest rates are adjusted quarterly, based upon the prior quarterly average of 91-day T-Bills (bond-equivalent yield), plus a current margin of 2.00%.

<sup>2</sup> SELF III loan interest rates are adjusted quarterly, based upon the prior quarterly average of the three month London Interbank Offered Rates (LIBOR), plus a current margin of 3.30%.

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**APPENDIX VII**

**FORM OF FINANCIAL GUARANTY INSURANCE POLICY**

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# FINANCIAL GUARANTY INSURANCE POLICY

## MBIA Insurance Corporation Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]  
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

\_\_\_\_\_  
President

Attest:

\_\_\_\_\_  
Assistant Secretary

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**APPENDIX VIII**

**FORM OF CONTINUING DISCLOSURE AGREEMENT**

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## FORM OF CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement, dated as of July 1, 2004 (the "Disclosure Agreement"), is executed and delivered by the Minnesota Higher Education Services Office (the "Issuer") and Wells Fargo Bank, N.A. (the "Dissemination Agent") in connection with the issuance of \$67,000,000 Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds 2004 Series A (Taxable) and \$88,500,000 Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds 2004 Series B (Tax Exempt) (collectively, the "Bonds"). The Bonds are being issued pursuant to a General Indenture, dated as of November 1, 1999 (the "General Indenture"), between the Issuer and Wells Fargo Bank, N.A., as bond trustee (the "Trustee"), as amended and supplemented by the Second Supplemental Indenture, dated as of January 1, 2002 (the "Second Supplemental Indenture"), the Third Supplemental Indenture, dated as of January 1, 2002 (the "Third Supplemental Indenture"), the Fourth Supplemental Indenture, dated as of June 1, 2003 (the "Fourth Supplemental Indenture"), the Fifth Supplemental Indenture, dated as of June 1, 2003 (the "Fifth Supplemental Indenture"), the Sixth Supplemental Indenture, dated as of July 1, 2004 (the "Sixth Supplemental Indenture"), and the Seventh Supplemental Indenture, dated as of July 1, 2004 (the "Seventh Supplemental Indenture") between the Issuer and the Trustee (the General Indenture, as amended and supplemented is herein referred to as the "Indenture").

**SECTION 1. Purpose of the Disclosure Agreement.** This Disclosure Agreement constitutes the written undertaking of the Issuer, for the benefit of the Bondholders (including any beneficial owners thereof when the Bonds are held in the book-entry system) to the extent stated herein and required by the Rule (defined below) thereby providing for the public availability of certain information relating to the Bonds and the security therefor and to permit participating underwriters in the primary offering of the Bonds to comply with the Rule, which will enhance the marketability of the Bonds.

**SECTION 2. Definitions.** In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Financial Information" shall comprise the following (subject to modification as provided in Section 3 hereof):

(1) A complete audit report and opinion of an Accountant and the financial statements of the Issuer for such fiscal year, containing balance sheets as of the end of such fiscal year and a statement of operations, changes in fund balance and cash flows for the fiscal year then ended, and showing in comparative form such figures for the preceding fiscal year of the Issuer, prepared in accordance with generally accepted accounting principles promulgated by the Financial Accounting Standards Board as modified in accordance with the governmental accounting standards promulgated by the Governmental Accounting Standards Board or as otherwise provided under Minnesota law, as in effect from time to time, or, if and to the extent such financial statements have not been prepared in accordance with such generally accepted accounting principles for reasons beyond the reasonable control of the Issuer, noting the discrepancies therefrom and the effect thereof, and certified as to accuracy and completeness in all material respects by the Director of Financial Services of the Issuer, to the best of his or her knowledge; and

(2) To the extent not included in the financial statements referred to in paragraph (1) hereof, the information for such fiscal year or the period most recently available of the type identified below, which information may be unaudited, but shall be certified as to accuracy and completeness in all material respects by the Director of Financial Services of the Issuer to the best of his or her knowledge, which certification may be based on the reliability of information obtained from governmental or other third-party sources, in the following general categories:

1. Information regarding the operating budget of the Issuer for the current fiscal year and the Loan Capital Fund for the most recent fiscal year of the type contained under the caption "Minnesota Higher Education Services Office—Financial Information" in the Official Statement.

2. Information for the most recent fiscal year regarding the amount of student loans originated, the outstanding principal balance of student loans as of the end of the most recent fiscal year and loan loss and recovery experience and borrower delinquencies for the most recent fiscal year of the type contained under the caption "The Supplemental Student Loan Program — SELF Program Overview" and "— Loss and Delinquency Experience for the Student Loan Portfolio" in the Official Statement.

"Beneficial Owners" means any person or entity which (a) has the power, directly or indirectly, to vote or consent with respect to, or dispose of ownership of any Bonds (including persons or entities holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

"Bondholder" shall mean the registered owner or owners thereof appearing in the bond register maintained by the Trustee or any Beneficial Owner thereof, if the Beneficial Owner provides to the Trustee evidence of such beneficial ownership in form and substance reasonably satisfactory to the Trustee.

"Disclosure Representative" shall mean the Director of Financial Services of the Issuer, or such other person as the Issuer shall designate in writing to the Dissemination Agent from time to time.

"Dissemination Agent" shall mean the Dissemination Agent, if any, designated in writing by the Issuer pursuant to the terms hereof. Initially, Wells Fargo Bank, N.A. shall act as the Dissemination Agent.

"Material Event" means any of the following events, if material for purposes of the purchase, holding or sale of a Bond within the meaning of applicable federal securities laws, as interpreted at the time of discovery of the occurrence of the event:

- (1) Principal and interest payment delinquencies;
- (2) Non-payment related defaults;
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties;
- (4) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (5) Substitution of credit or liquidity providers, or their failure to perform;
- (6) Adverse tax opinions or events affecting the tax-exempt status of the security;
- (7) Modifications to rights of security holders;
- (8) Bond calls;
- (9) Defeasances;
- (10) Release, substitution, or sale of property securing repayment of the securities; and
- (11) Rating changes.

"Material Event Notice" means written or electronic notice of a Material Event prepared in accordance with applicable federal securities laws.

"MSRB" means the Municipal Securities Rulemaking Board or any successors to its functions. The current address of the MSRB is 1900 Duke Street, Suite 600, Alexandria, Virginia 22314.

"NRMSIR" means, as of the date of determination, a nationally recognized municipal securities information repository, as recognized from time to time by the Securities and Exchange Commission for the purposes referred to in the Rule. The NRMSIRs as of the date of this Disclosure Agreement are as follows:

Bloomberg Municipal Repository  
100 Business Park Drive  
Skillman, New Jersey 08558  
Phone: (609) 279-3225  
Fax: (609) 279-5962  
Email: munis@bloomberg.com

FT Interactive Data  
Attn: NRMSIR  
100 William Street  
New York, New York 10038  
Phone: (212) 771-6999  
Fax: (212) 771-7390 (Secondary Market Information)  
(212) 771-7391 (Primary Market Information)  
Email: NRMSIR@FTID.com

Standard & Poor's J. J. Kenny Repository  
55 Water Street  
45<sup>th</sup> Floor  
New York, New York 10041  
Phone: (212) 438-4595  
Fax: (212) 438-3975  
Email: nrmsir\_respository@sandp.com

DPC Data Inc.  
One Executive Drive  
Fort Lee, New Jersey 07024  
Phone: (201) 346-0701  
Fax: (201) 947-0107  
Email: nrmsir@dpcdata.com

"Official Statement" means the Official Statement dated July 20, 2004, delivered in connection with the original issue and sale of the Bonds.

"Rule" shall mean Rule 15c2-12 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"SID" means, as of the date of determination, any state information depository as operated or designated by the State of Minnesota as such for the purposes referred to in the Rule. As of the date of this Agreement, there is no SID.

"Underwriter" shall mean RBC Dain Rauscher Inc. and any other underwriter of the Bonds required to comply with the Rule in connection with the primary offering of the Bonds for sale.

### SECTION 3. Undertaking to Provide Ongoing Disclosure.

(a) It is the express intention of the Issuer that the Bondholders (including any Beneficial Owners hereof when the Bonds are in the book-entry system) be a beneficiary of this Disclosure Agreement with the right to enforce this Disclosure Agreement directly against the Issuer to the extent set forth in Section 9 hereof.

(b) The Issuer, as an "obligated person" within the meaning of the Rule, undertakes to provide the following information:

- (1) Annual Financial Information, and
- (2) Material Event Notices.

(c) The Issuer shall provide, or shall cause the Dissemination Agent to provide, while any Bonds are outstanding, Annual Financial Information to each then existing NRMSIR and the SID, if any, not later than 155 days after the end of the Issuer's fiscal year (the "Report Date"), commencing with the fiscal year ending June 30,

2004. In addition, five days prior to the Report Date (the "Submission Date"), the Disclosure Representative shall submit the Annual Financial Information to the Dissemination Agent. If a Dissemination Agent has been designated, the Disclosure Representative shall include with each submission of Annual Financial Information to the Dissemination Agent a written representation addressed to the Dissemination Agent to the effect that the Annual Financial Information is the Annual Financial Information required by this Section and that it complies with the applicable requirements of this Disclosure Agreement. The Dissemination Agent may conclusively rely upon such written representation of the Disclosure Representative. The Dissemination Agent's obligation to deliver the information at the times and with the contents described above shall be limited to the extent the Disclosure Representative has provided such information to the Dissemination Agent as required hereby. If the Issuer changes its fiscal year (thereby changing the Report Date and the Submission Date), the Disclosure Representative shall provide written notice of the change of fiscal year and the new Report Date and Submission Date to the Dissemination Agent, if any, each then existing NRMSIR and the SID, if any; provided that the period between the final Report Date relating to the former fiscal year and the initial Report Date relating to the new fiscal year shall not exceed one year in duration.

Notwithstanding the foregoing, if the audited financial statements comprising part of the Annual Financial Information are not available by the date specified, the Issuer shall provide on or before the Report Date and the Submission Date unaudited financial statements in the format required as part of the Annual Financial Information and, within 10 days after the receipt of the audited financial statements, the Issuer shall provide the audited financial statements.

Any or all of the Annual Financial Information may be incorporated, if it is updated as required hereby, by reference from other documents, including official statements, which have been submitted to each of the then existing NRMSIRs, the SID, if any or the SEC. If the document incorporated by reference is a final official statement, it must also be available from the MSRB. The Issuer shall clearly identify in the Annual Financial Information each document so incorporated by reference.

If any part of the Annual Financial Information can no longer be generated because the operations of the Issuer have materially changed or been discontinued, such Annual Financial Information need no longer be provided if the Issuer includes in the Annual Financial Information a statement to such effect; provided, however, if such operations have been replaced by other Issuer operations in respect of which data is not included in the Annual Financial Information and the Issuer determines that certain specified data regarding such replacement operations would be material for purposes of the purchase, holding or sale of a Bond within the meaning of applicable federal securities laws, as interpreted at the time, then, from and after such determination, the Annual Financial Information shall include such additional specified data regarding the replacement operations.

If the Annual Financial Information is changed or this Disclosure Agreement is amended as permitted by this Section 3(c) or Section 7 hereof, then the Issuer shall include in the next Annual Financial Information to be delivered hereunder, to the extent necessary, an explanation of the reasons for the amendment and the effect of any change in the type of financial information or operating data provided.

(d) If a Material Event occurs while any Bonds are outstanding, the Disclosure Representative shall provide, or shall provide to the Dissemination Agent, if any, for dissemination a Material Event Notice in a timely manner to each then existing NRMSIR (or the MSRB) and to the SID, if any. Each Material Event Notice shall be so captioned and shall prominently state the date, title and CUSIP numbers of the Bonds.

(e) The Dissemination Agent shall promptly (but in any event within five Business Days) advise the Disclosure Representative whenever, in the course of performing its duties as Trustee under the Indenture, the Trustee identifies an occurrence which, if material, would require the Issuer to provide a Material Event Notice pursuant to clause (d) above; provided that the failure of the Trustee so to advise the Disclosure Representative of such occurrence shall not constitute a breach by the Trustee of any of its duties and responsibilities under the Indenture and shall not excuse or suspend any obligation of the Issuer under subsection (d). If in response to a notice under this subsection, the Disclosure Representative determines that the event would not be material, the Disclosure Representative shall so notify the Trustee and shall not be required to report the occurrence pursuant to subsection (d).

(f) The Disclosure Representative shall provide notice in a timely manner to each then existing NRMSIR (or the MSRB) and to the SID, if any, of any failure while any Bonds are outstanding to provide Annual Financial Information on or before the Report Date (for any reason) as provided herein.

(g) The Disclosure Representative may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent may resign at any time by providing 30 days' written notice to the Issuer and the Disclosure Representative. If no Dissemination Agent has been appointed or engaged or if a Dissemination Agent resigns or is otherwise removed and no successor Dissemination Agent is appointed or engaged, the Disclosure Representative shall perform all of the duties and assume all of the obligations of the Dissemination Agent hereunder.

(h) If a Dissemination Agent has been designated, the Dissemination Agent shall:

(i) If the Disclosure Representative provides to the Dissemination Agent information, which information is not designated as a Material Event Notice, and directs the Dissemination Agent to provide such information to information repositories, provide such information in a timely manner to each then existing NRMSIR (or the MSRB) and the SID, if any;

(ii) If by the Submission Date, the Dissemination Agent has not received a copy of the Annual Financial Information, contact the Disclosure Representative to determine if the Issuer is in compliance with subsection (c);

(iii) If the Dissemination Agent has not itself provided or received the representation from the Disclosure Representative that it has provided the Annual Financial Information to each then existing NRMSIR and the SID, if any, by the Report Date send a notice to each then existing NRMSIR and the SID, if any, in substantially the form attached as Exhibit A; and

(iv) If the Annual Financial Information has been disseminated by the Dissemination Agent, file a report with the Disclosure Representative certifying that the Annual Financial Information has been provided pursuant to this Disclosure Agreement, stating the date it was provided, and listing all parties to which it was provided.

(i) The Disclosure Representative shall determine prior to each date for providing the Annual Financial Information or Material Event Notices, the name and address of each NRMSIR and SID, if any.

(j) Unless otherwise required by the Rule, the Disclosure Representative and the Dissemination Agent, if any, shall employ such methods of information transmission as shall be required or recommended by the designated recipients of the Annual Financial Information and Material Event Notices.

(k) Notwithstanding the foregoing,

(i) notice of the occurrence of an event described in clauses (i), (viii) or (ix) of the definition of "Material Event" shall be given by the Dissemination Agent, if any, unless the Disclosure Representative gives the Dissemination Agent affirmative instructions not to disclose such occurrence; and

(ii) notice of events described in clauses (viii) and (ix) of the definition of "Material Event" need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the Bondholders of affected Bonds pursuant to the Indenture.

#### SECTION 4. Obligated Persons.

(a) In the event that any other person subsequently becomes an obligated person on the Bonds (as defined in the Rule), the Issuer agrees to use its best efforts to cause such person to enter into a written undertaking to comply with the provisions set forth in this Disclosure Agreement.

(b) Any such obligated person (other than the Issuer) reserves the right to terminate its obligation to provide Annual Financial Information, and notices of Material Events, as set forth above, if and when such person is no longer an obligated person with respect to the Bonds within the meaning of the Rule. The Disclosure Representative will provide notice of any such termination to the Trustee, each then existing NRMSIR and the SID, if any.

(c) If the Issuer's obligations under the Indenture are assumed in full by some other person or entity, such person or entity shall assume, in a written agreement satisfactory in form and substance to the Trustee, and be responsible for compliance with this Disclosure Agreement in the same manner as if it were the Issuer and the Issuer shall have no further responsibility hereunder.

SECTION 5. Termination of Reporting Obligation. The continuing obligation hereunder of the Issuer to provide Annual Financial Information and Material Event Notices hereunder shall terminate immediately once the Bonds are no longer Outstanding (as defined in the Indenture).

SECTION 6. Disclosure Representative. The Issuer shall, from time to time, appoint or engage a Disclosure Representative to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Disclosure Representative, upon appointment of a successor Disclosure Representative. If at any time there is not any other designated Disclosure Representative, the Issuer shall perform all the obligations and duties of the Disclosure Representative hereunder.

SECTION 7. Amendments. This Disclosure Agreement (and the form and requirements of the Annual Financial Information) may not be amended or supplemented except in a writing executed by the parties hereto and with the consent of the Trustee (which consent shall not be unreasonably withheld or delayed) accompanied by an opinion of counsel expert in federal securities law, who may rely on certificates of the Issuer and others and the opinion may be subject to customary qualifications, to the effect that: (i) such amendment or supplement (a) is made in connection with a change in circumstances that arises from a change in law or regulation or a change in the identity, nature or status of the Issuer or the type of operations conducted by the Issuer, or (b) is required by, or better complies with, the provisions of paragraph (b)(5) of the Rule; (ii) this Disclosure Agreement as so amended or supplemented would have complied with the requirements of paragraph (b)(5) of the Rule at the time of the primary offering of the Bonds, giving effect to any change in circumstances applicable under clause (i)(a) and assuming that the Rule as in effect and interpreted at the time of the amendment or supplement was in effect at the time of the primary offering; and (iii) such amendment or supplement does not materially impair the interests of the Bondholders under the Rule. This Disclosure Agreement may be amended or supplemented from time to time without notice to or the consent of the Bondholders (except as otherwise provided in Section 11 hereof).

If the Annual Financial Information is amended pursuant to this Section 7, the Issuer agrees to provide to each existing NRMSIR (or the MSRB) and the SID, if any, contemporaneously with the effectiveness of such amendment, an explanation of the reasons for the amendment and the effect, if any, of the change in the type of financial information or operating data being provided hereunder.

SECTION 8. Additional Information. Nothing in this Disclosure Agreement shall be deemed to prevent the Issuer from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Financial Information or notice of occurrence of a Material Event, in addition to that which is required by this Disclosure Agreement.

SECTION 9. Default. In the event of a failure of the Issuer or the Disclosure Representative, on behalf of the Issuer, to comply with any provision of this Disclosure Agreement, the Dissemination Agent may and, at the written request of the Underwriter or the Bondholders of at least 25% aggregate principal amount of outstanding Bonds, shall, solely to the extent indemnified to its satisfaction, including attorney fees and expenses), or any

Bondholders, as third-party beneficiaries hereof, may take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the Issuer or the Disclosure Representative, on behalf of the Issuer, to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Bonds or the Indenture and the sole remedy under this Disclosure Agreement in the event of any failure of the Issuer or the Disclosure Representative, on behalf of the Issuer, to comply with this Disclosure Agreement shall be an action to compel performance, and no person or entity shall be entitled to recover any monetary damages hereunder in any circumstance.

SECTION 10. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in the Disclosure Agreement, and the Issuer agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the reasonable costs and expenses (including attorneys' fees and expenses) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the Issuer under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds. In the absence of bad faith on its part, the Dissemination Agent may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Dissemination Agent and conforming to the requirements of this Disclosure Agreement. In the case of any Annual Financial Information disclosure, or any Material Event disclosure, or any opinions which, by any provision hereof, are specifically required to be furnished to the Dissemination Agent, the Dissemination Agent shall be under a duty to examine the same to determine whether or not they conform to the requirements of this Disclosure Agreement, but shall be under no duty to verify independently or investigate the accuracy or completeness of any information contained therein or the correctness of any opinion furnished hereunder. If the Dissemination Agent is other than the Issuer, no provision of this Continuing Disclosure Agreement shall require the Dissemination Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, provided that the Dissemination Agent shall pay such reasonable expenses, disbursements and advances necessary to perform its obligations hereunder, which expenses, disbursements and advances are expected to be reimbursed under Section 12 hereof.

SECTION 11. Binding Effect; Bondholders as Third-Party Beneficiaries. This Disclosure Agreement shall inure to the benefit of and shall be binding upon the Issuer and the Dissemination Agent and their respective successors and permitted assigns. In addition, this Disclosure Agreement shall constitute a third-party beneficiary contract for the benefit of the Bondholders from time to time. Said third-party beneficiaries shall be entitled to enforce performance and observance by the parties of the respective agreements and covenants herein contained as fully and completely as if said third-party beneficiaries were parties hereto; provided that this Disclosure Agreement (other than this Section 11) may be amended or supplemented from time to time without notice to or the consent of such third-party beneficiaries. Nothing in this Disclosure Agreement, express or implied, shall give to any Person, other than the parties hereto and their respective successors and permitted assigns as provided herein, and the Bondholders, any benefit or other legal or equitable right, remedy or claim under this Disclosure Agreement.

SECTION 12. Compensation. The Issuer hereby agrees to compensate the Dissemination Agent, if someone other than the Issuer is appointed, for the services provided and the reasonable expenses incurred pursuant to this Disclosure Agreement, in an amount to be agreed upon from time to time hereunder, and to reimburse the Dissemination Agent upon its request for all reasonable expenses, disbursements and advances incurred by the Dissemination Agent hereunder (including any reasonable compensation and expenses of counsel) except any such expense, disbursement or advance that may be attributable to its negligence or willful misconduct.

SECTION 13. Counterparts. This Disclosure Agreement may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

SECTION 14. Governing Law; Construction. The Disclosure Agreement shall be governed by and construed in accordance with the laws of the State of Minnesota. This Disclosure Agreement is entered into to comply with the continuing disclosure provisions of the Rule and should be construed so as to satisfy the requirements of paragraph (b)(5) of the Rule.

SECTION 15. Notices. Notices to be given to the Issuer or, if it is the Dissemination Agent hereunder, the Trustee shall be given to them at the addresses and in the manner specified in or pursuant to the Indenture.

SECTION 16. Representations. Each of the parties hereto represents and warrants to each other party that (i) it has all requisite power and authority to execute, deliver and perform this Disclosure Agreement under applicable law and any resolutions or other actions of such party now in effect, (ii) it has duly authorized the execution and delivery of this Disclosure Agreement, (iii) the execution and delivery of this Disclosure Agreement and performance of the terms hereof by such party do not and will not violate any law, regulation, ruling, decision, order, indenture, decree, agreement or instrument to which it is a party or by which it is bound, and (iv) to its best knowledge, no litigation, proceeding or administrative matter is pending to which it is a party, or overtly threatened, contesting or questioning the legal existence of such party, its power and authority to enter into and perform this Disclosure Agreement or its due authorization, execution and delivery of this Disclosure Agreement.

The Issuer represents and warrants that it is the only "obligated person" in respect of the Bonds within the meaning of the Rule and that it has complied in all material respects with all undertakings previously entered into by it under the Rule.

Date: July 1, 2004

Wells Fargo Bank, N.A., as Dissemination Agent

By: \_\_\_\_\_  
Authorized Officer

Minnesota Higher Education Services Office

By: \_\_\_\_\_  
Its: Director

Signature page for Continuing Disclosure Agreement, dated as of July 1, 2004, between Wells Fargo Bank, N.A. and Minnesota Higher Education Services Office.



**EXHIBIT A**

**MINNESOTA HIGHER EDUCATION SERVICES OFFICE  
SUPPLEMENTAL STUDENT LOAN PROGRAM REVENUE BONDS**

**NOTICE OF FAILURE TO FILE ANNUAL REPORT**

Name of Issuer: Minnesota Higher Education Services Office

Name of Bond Issue: \$67,000,000 Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds 2004 Series A (Taxable) and \$88,500,000 Minnesota Higher Education Services Office Supplemental Student Loan Program Revenue Bonds 2004 Series B (Tax Exempt)

Date of Issuance: July 29, 2004

NOTICE IS HEREBY GIVEN that the Issuer has not provided the annual financial information with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Agreement, dated as of July 1, 2004, between Minnesota Higher Education Services Office, as Issuer, and Wells Fargo Bank, N.A., as dissemination agent. The Issuer anticipates that the annual financial information will be filed by \_\_\_\_\_.

Dated:

[Trustee] on behalf of the Issuer

cc: Disclosure Representative By: \_\_\_\_\_  
[if notice is sent by Dissemination  
Agent.] Its: \_\_\_\_\_

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