

CONSOLIDATED FINANCIAL STATEMENTS

The Education Financing Foundation of California (Name Changed to
College Access Foundation of California in March 2007)

Years Ended December 31, 2006 and 2005

With Report of Independent Auditors

The Education Financing Foundation of California

Consolidated Financial Statements

Years Ended December 31, 2006 and 2005

Contents

Report of Independent Auditors.....	1
Audited Consolidated Financial Statements	
Consolidated Statements of Financial Position.....	2
Consolidated Statements of Activities and Changes in Net Assets	3
Consolidated Statements of Cash Flows.....	4
Notes to Consolidated Financial Statements.....	5

Report of Independent Auditors

The Board of Directors
The Education Financing Foundation of California

We have audited the accompanying consolidated statements of financial position of The Education Financing Foundation of California (TEFFC) as of December 31, 2006 and 2005, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of TEFFC'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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of internal control over financial reporting. Our audit included consideration of internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of TEFFC's internal control over financial reporting. Accordingly, we express no such opinion. 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of TEFFC at December 31, 2006 and 2005, and the consolidated results of its changes in net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

June 18, 2007

The Education Financing Foundation of California

Consolidated Statements of Financial Position

	December 31	
	2006	2005
	<i>(In Thousands)</i>	
Assets		
Cash and cash equivalents	\$ 19,014	\$ 138,214
Investments	421,848	217,925
Student loans receivable, net of allowance for loan losses of \$599 and \$6,716, respectively	12,178	175,995
Student loans receivable held for sale	–	181,758
Other assets	1,723	9,078
	\$ 454,763	\$ 722,970
Liabilities		
Accounts payable and accrued liabilities	\$ 7,030	\$ 12,278
Accrued interest payable	155	629
Grants payable	2,578	–
Student loans held for sale funding provided by Nelnet	–	181,758
Bonds and note payable	11,145	40,192
Asset-backed line of credit	–	113,000
Total liabilities	20,908	347,857
Net Assets		
Net assets restricted by trust indentures	357	22,940
Unrestricted net assets	433,498	352,173
Total net assets	433,855	375,113
Total liabilities and net assets	\$ 454,763	\$ 722,970

See accompanying notes.

The Education Financing Foundation of California

Consolidated Statements of Activities and Changes in Net Assets

	Years Ended December 31	
	2006	2005
	<i>(In Thousands)</i>	
Revenues		
Interest and investment income:		
Student loan interest, including special allowance payments	\$ 4,718	\$ 124,014
Investments, including net realized and unrealized gains	54,723	23,326
Gain on sale of loans and other assets	19,457	41,105
Other income	380	-
Total revenues	<u>\$ 79,278</u>	<u>\$ 188,445</u>
Expenses		
Loss on extinguishments of debt	\$ 288	\$ 11,580
Interest	3,705	65,181
Loan servicing fees	529	7,966
Student loan program expenses	1,260	21,902
Scholarships and grants	5,763	2,406
Salaries and benefits	4,720	21,512
General and administrative	4,271	19,293
Total expenses	<u>20,536</u>	<u>149,840</u>
Increase in net assets	58,742	38,605
Net assets at beginning of year	375,113	336,508
Net assets at end of year	<u>\$ 433,855</u>	<u>\$ 375,113</u>

See accompanying notes.

The Education Financing Foundation of California

Consolidated Statements of Cash Flows

	Years Ended December 31	
	2006	2005
	<i>(In Thousands)</i>	
Operating activities		
Increase in net assets	\$ 58,742	\$ 38,605
Adjustments to reconcile increase in net assets to net cash provided by/(used in) operating activities:		
Amortization of deferred loan premiums, transfer fees, and financing costs	320	15,739
Provision for loan losses	771	1,336
Net realized and unrealized gains on investments	(44,276)	(6,071)
Net gain on sale of student loans and other assets	(19,457)	(41,105)
Loss on extinguishment of debt	288	11,580
Changes in operating assets and liabilities:		
Net decrease/(increase) in accrued interest and other receivables	9,799	(9,506)
Net decrease/(increase) in other assets	6,906	(420)
Net decrease in accounts payable and accrued liabilities	(4,623)	(13,951)
Net increase in grants payable	2,578	-
Net decrease in accrued interest payable	(474)	(3,019)
Other	(1,010)	(2,222)
Net cash provided by/(used in) operating activities	<u>9,564</u>	<u>(9,034)</u>
Investing activities		
Purchases and originations of student loans	(5,263)	(548,939)
Proceeds from student loan repayments	31,783	546,311
Net proceeds from sale of student loans to third party	146,410	2,322,687
Net decrease in deferred loan premiums and transfer fees	-	(7,707)
Proceeds from sale of other assets to third party	-	11,000
Net purchases of investments	(159,647)	(75,186)
Net cash provided by investing activities	<u>13,283</u>	<u>2,248,166</u>
Financing activities		
Repayment of bonds and note payable	(29,047)	(2,142,637)
Net borrowings under asset-backed lines of credit	(113,000)	(181,000)
Net cash used in financing activities	<u>(142,047)</u>	<u>(2,323,637)</u>
Net decrease in cash and cash equivalents	(119,200)	(84,505)
Cash and cash equivalents at beginning of year	138,214	222,719
Cash and cash equivalents at end of year	<u>\$ 19,014</u>	<u>\$ 138,214</u>

See accompanying notes.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements

December 31, 2006 and 2005

1. Organization, Business, and Name Change

The Education Financing Foundation of California (TEFFC or the Foundation) and its subsidiary, CEFI Corporation (CEFI), were the surviving entities after a series of corporate restructurings that were designed to enable TEFFC to fulfill its mission to help qualified students in California who have financial need attend college and to achieve its goals to increase college-going rates among student populations that have had historically low college-going rates and to provide sufficient aid to scholarship recipients to enroll and remain enrolled in college. TEFFC accomplishes this by making grants to charitable organizations that, in turn, award scholarships to students. On March 7, 2007, TEFFC changed its name to College Access Foundation of California. This series of corporate restructurings is described more fully below.

At the start of 2005, Chela Financial Resources, Inc. (Resources) and its affiliate, Chela Inc., were nonprofit public benefit corporations organized for the charitable purpose of assisting students in obtaining funds for educational purposes and for providing various education loan assistance programs and loan servicing. Chela Inc. was incorporated on April 23, 1979 and was organized under Internal Revenue Service (IRS) Code Section 150(d) as a corporation established and operated exclusively for the purpose of acquiring student loans originated under the Higher Education Act of 1965, as amended. Resources was incorporated on May 11, 1994 and commenced operations on January 1, 1995. Both entities were incorporated under the laws of the State of California.

Under Chela Inc.'s Articles of Incorporation, as required pursuant to IRC Section 150(d), Chela Inc. was required to apply all of its net income (i.e., income after expenses, debt service, and related reserves) to the acquisition of additional student loans authorized under the Higher Education Act. In addition, Chela Inc. would have been required, upon dissolution, to return its net assets to the United States government.

Recognizing the problems inherent in these restrictions and the benefits from enabling IRC Section 150(d) corporations to utilize their assets more flexibly for the charitable purpose of benefiting and advancing education, Congress enacted IRC Section 150(d)(3). This section specifically authorizes IRC Section 150(d) corporations to elect to transfer all of their liabilities and pledged student loan assets to a wholly owned for-profit subsidiary, subject to explicit statutory requirements and conditions. In late 2004, Chela Inc.'s management embarked on a program to take advantage of the benefits of this new legislation and initiated the organizational changes and sale of assets to Nelnet Corporation (Nelnet) described more fully below.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

1. Organization, Business, and Name Change (continued)

On January 31, 2005 and on February 1, 2005, respectively, Chela Inc. and Resources underwent corporate restructurings involving the following three principal separate but related transactions:

- (i) The Internal Revenue Code (IRC) Section 150(d)(3) “conversion” of Chela Inc. This conversion involved the transfer of substantially all of Chela Inc.’s assets, including its rights and obligations under the bond indentures and an asset-backed line of credit, to CEFI, a newly created for-profit Delaware corporation, in exchange for CEFI’s issuance of Senior Stock to Chela Inc., such that Chela Inc. would own all of the outstanding capital stock of CEFI. The name of Chela Inc. was subsequently changed to TEFFC;
- (ii) The merger of Resources with and into Chela Inc., with Chela Inc. as the surviving corporation in the merger; and
- (iii) The transfer of substantially all of Resources’ assets, liabilities, business, and employees to CEFI.

In connection with the foregoing transactions, CEFI established two wholly owned single-purpose financing subsidiaries, Chela Funding I, LLC (CFI) and Chela Funding II, LLC (CFII), and transferred certain of its assets and liabilities to each.

The foregoing transactions constituted a purely internal restructuring of entities under common control. Chela Inc. (now TEFFC) remains an IRC Section 501(c)(3) exempt charitable organization.

On December 31, 2006, CFI and CFII were merged into CEFI, with CEFI being the surviving entity. Accordingly, the merger of nonprofit entities was accounted for as a reorganization of entities under common control, and all of the assets and liabilities of CFI and CFII were merged into CEFI based on their historical book values.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

1. Organization, Business, and Name Change (continued)

Prior to the sale of assets to Nelnet, TEFFC's primary source of revenue was interest on student loans. CEFI and its predecessors issued student loan revenue bonds and asset-backed lines of credit to fund student loan acquisition programs, including those loans originated by Resources. These financings were repaid primarily from funds derived from principal repayments, borrower interest and fee payments, special allowance payments, government interest payments, guarantee payments on defaulted loans, proceeds from sales of student loans, proceeds from bonds or notes issued to refund such bonds, and investment income. After the sale of assets to Nelnet, TEFFC's primary source of revenue was from interest and investment income.

2. Sale of Assets and Wind-Down of CEFI

On October 25, 2005, under the terms of the Asset Purchase Agreement (APA) with Nelnet, CEFI sold the majority of its assets to Nelnet. This sale included substantially all of CEFI's FFELP student loan assets, totaling approximately \$2.2 billion, along with related origination, servicing operations, and intellectual property and trademarks. The gain on sale from this transaction totaled \$42.8 million in 2005 and \$14.9 million in 2006. The sale of FFELP loans encompassed all loans except those loans that were more than 210 days delinquent. This sale did not include the private student loan portfolios that CEFI and its predecessors had purchased or originated.

Concomitant with the sale of loan portfolios to Nelnet, the bonds that financed each asset pool were defeased with proceeds of the sales such that TEFFC and its subsidiaries had no further obligations to the bondholders whose bonds were shortly thereafter redeemed by the trustee for each bond issue. Loss on extinguishment of debt related to the write-off of deferred financing costs totaled \$11.6 million in 2005. One bond issue (Series 1998AB) and a portion of an asset-backed credit line were defeased in 2006 resulting in a loss on extinguishment of debt of approximately \$288,000. The \$20.5 million of FFELP loans that collateralized this bond were sold to Nelnet. Simultaneously with the note redemption, an associated swap agreement terminated. Pursuant to the requirements of the APA, CFI then changed its name to CEFI Funding I, LLC.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

2. Sale of Assets and Wind-Down of CEFI (continued)

In addition to the sale of the available FFELP portfolios (other than loans more than 210 days delinquent), CEFI contracted to sell to Nelnet future FFELP loan originations for those loans that were either partially disbursed or for which applications were in process but not yet disbursed at the time of initial sale, as long as the first disbursement of such loans occurred on or before January 23, 2006. CEFI was paid a premium by Nelnet when these loans were subsequently sold. The contract also provided that those loans that collateralized the 1998AB bond financing would be sold to Nelnet once the principal amount of such collateral reduced to below \$22.0 million, at which stage the bonds would be redeemed by CFI. In 2006, the loans collateralizing the 1998AB bond were sold to Nelnet and the bonds were defeased.

Furthermore, if any previously delinquent FFELP loans became less than 210 days delinquent, the agreement with Nelnet provided that these would be sold to Nelnet at par or without any premium.

Aside from the purchase of loans and other assets as discussed above, there were a number of other contractual arrangements entered into between CEFI and Nelnet. These included the contracting of Nelnet to provide future servicing or oversight of third-party servicers for those loans retained by CEFI. Nelnet assumed from CEFI a variety of contracts with third parties in connection with the acquired business activities, including any rights to purchase loans under forward purchase contracts. CEFI contracted to provide certain management and administrative services to Nelnet during a transition period to end no later than June 30, 2006.

For a period of 36 months from the initial purchase date of October 25, 2005, Nelnet may require CEFI to repurchase any of the purchased loans under a variety of specified circumstances. Generally, these circumstances relate to events or actions prior to the date Nelnet purchased the loans. Any such repurchases are to be at a comparable premium to the purchase price Nelnet had originally paid plus any incidental costs to fully compensate Nelnet. CEFI has established an indemnification reserve of \$0.8 million at December 31, 2005 against potential repurchases of this nature. Repurchases through May 31, 2007 have been negligible.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

2. Sale of Assets and Wind-Down of CEFI (continued)

On March 27, 2006, The Foundation entered into an Administrative Services Agreement with the California Alternative Loan Marketing Association (CALMA) whereby CALMA assumed the Foundation's administrative and program duties under the 1998 Indenture and Program Administration Agreement for the CalEdge student loan program.

On June 8, 2006, TEFFC consummated a sale of the remaining \$93.0 million consumer education loan (CEL loan) portfolio. The gain on sale for this transaction totaled \$4.6 million. Concomitant with this event, the Amended and Restated Indenture dated January 31, 2005 between Citicorp North America, Inc. (CNAI) and Chela Funding II, LLC was terminated. Pursuant to the APA, CFII then changed its name to CEFI Funding II, LLC.

Throughout 2006, TEFFC periodically sold additional loans to Nelnet as previously 120 day or more delinquent loans were brought current.

After the sale of assets to Nelnet, CEFI management turned its attention to winding down the CEFI business and transferring management of the remaining assets and selected personnel to TEFFC. As part of the wind-down, payments under retention and severance arrangements were accrued and paid to employees at termination. Some employees of CEFI were hired by Nelnet in conjunction with the asset purchases, and some were retained by CEFI on a temporary basis to perform transitional tasks for Nelnet with their compensation costs reimbursed by Nelnet. The remaining employees of CEFI were retained to perform the wind-down tasks, with most terminations taking place during the later part of 2005 and first half of 2006. Three CEFI employees were transitioned to TEFFC.

Retention and severance bonuses expense totaled \$5.0 million in 2005 and \$1.0 million in 2006. At December 31, 2005, the retention and severance bonus liability was \$1.3 million. This was fully paid in 2006. The expense has been included in the salaries and benefits category on the Consolidated Statement of Activities and Changes in Net Assets.

In December 2006, CEFI management took action to terminate its 403(b) and 401(k) retirement plans.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

3. Subsequent Events

After the completion of distribution of all account balances to former employees of CEFI, the 401(k) plan was terminated on January 18, 2007.

Employees still retain balances in the 403(b) plan; therefore, termination had not yet taken place at May 15, 2007. A pending change in the law will enable TEFFC to terminate the plan when it becomes effective.

In April 2007, one of CEFI's servicers, ACS, informed CEFI that an audit had revealed an error in the software system that calculated average student loan balances outstanding used by the U.S. Department of Education (DOE) to calculate Special Allowance Payment (SAP) and government interest payments. The error produced an overstatement of SAP and government interest for a period of approximately 10 years. ACS reported that the DOE's overpayment to CEFI totaled \$2.1 million. The DOE will invoice CEFI for this amount plus interest with its second quarter 2007 filing. As the error related to conditions in existence at December 31, 2006, CEFI has reflected this amount as due to the DOE on its consolidated statement of financial position. The amount has been recorded as a reduction to student loan interest, including special allowance payments in the consolidated statements of activities and changes in net assets.

In June 2007, CEFI received a refund of \$0.8 million from the DOE which accepted CEFI's filing relating to underpayment of SAP income in prior periods (refer to Note 7).

4. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States that require management to make estimates and assumptions that affect reported amounts. These estimates are based on information available as of the date of the consolidated financial statements. Therefore, actual results could differ from those estimates.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

Under the provisions of the American Institute of Certified Public Accountants (AICPA) *Audit and Accounting Guide for Not-for-Profit Organizations* and related standards, net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. At December 31, 2006 and 2005, there were no donor-imposed restrictions. Therefore, according to AICPA standards, net assets of TEFFC were unrestricted. However, a portion of net assets is restricted by the trust indentures.

The consolidated financial statements include the accounts of TEFFC, its subsidiary, and their predecessors, CEFI, as well as the accounts of the trusts for the outstanding student loan revenue bonds, notes, the asset-backed line of credit, and the general operating accounts for each of the consolidated entities. All significant intercompany accounts and transactions have been eliminated. References to TEFFC in these notes to consolidated financial statements refer to or include TEFFC, its subsidiary, and their predecessors.

Fund Accounting

The accounts of TEFFC, its subsidiary, and their predecessors included in these consolidated financial statements are maintained in accordance with the principles of fund accounting as required by the trust indentures. This is a system under which resources are classified for accounting purposes into funds established for specific purposes. The individual entities' funds are maintained based on the source of the funding.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits in banks, money market funds, and other short-term investments with original maturities of 90 days or less. Certain cash and cash equivalents are held in trust with Union Bank of California, National Association (the Trustee) under trust indentures, and access to those funds is subject to certain limitations (see Note 5, Trust Indenture Restrictions). Cash equivalents are also held in custodian accounts pending future calls for certain investments.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

Investments

Investments are stated at fair value on the consolidated statements of financial position, with unrealized gains and losses reported as increases or decreases in net assets in TEFFC's statements of activities and changes in net assets. Certain investments for which there are no active market quotes are initially valued at cost. Subsequently, these investments are adjusted to reflect changes in valuation as indicated by periodic statements from fund managers. Dividend income is recorded on ex-dividend dates. Interest income from investments is recorded on an accrual basis.

Student Loans Receivable and Student Loans Receivable Held for Sale

Student loans held for investment are classified as portfolio loans and are carried at the principal amount outstanding net of unamortized premiums or discounts, deferred loan fees and costs, and acquisition fair value adjustments, if any. Student loan receivables that CEFI has committed to sell are classified as loans held for sale. Loans held for sale are carried at the lower of the carrying amount or fair value applied on an aggregate basis. Fair value is measured based on purchase commitments, bids received from potential purchasers, quoted prices for the same or similar loans, or prices of recent sales.

As a result of the Nelnet Asset Purchase Agreement, FFELP loans originated are classified as held for sale upon origination based upon management's intent to sell all of these loans to Nelnet. Loans originated for the portfolio and subsequently transferred to held for sale, based on management's decision to sell, are transferred at the lower of cost or fair value. Write-downs of the loans' carrying value attributable to credit quality are charged to the allowance for loan losses, while write-downs attributable to interest rates are charged to noninterest income.

At December 31, 2005, CEFI had a balance of \$181.8 million of loans held for sale. These loans were sold to Nelnet during 2006. There are no loans held for sale remaining at December 31, 2006.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

Student Loan Income

Interest income on student loans includes borrower interest, government interest, and special allowance payments. Interest income is recognized based upon the interest rate and principal amount outstanding in accordance with the terms of the applicable loan agreement until the outstanding balance is paid or charged off.

Loan premiums, discounts, transfer fees, and certain incremental direct origination costs are deferred and amortized into interest income over the estimated lives of the student loans using a method that approximates the effective-yield method. Amortization of deferred loan premium, transfer fees, and origination costs for the years ended December 31, 2006 and 2005 totaled \$0.2 million and \$14.8 million, respectively.

Allowance for Loan Losses

TEFFC maintains an allowance for loan losses to provide for probable net losses on the uninsured portion of its federally guaranteed FFELP student loans and on both privately guaranteed and uninsured consumer education loans (CEL loans). The allowance is maintained at a level to provide for probable losses, net of estimated recoveries, inherent in the portfolio as of the reporting date. The allowance is established through a provision charged to student loan program expenses, as well as through guarantee fees associated with certain CEL loan programs.

In evaluating the adequacy of the allowance for federally guaranteed FFELP loans, TEFFC also considers the incidence of student loan claims rejected for payment by guarantors and the amount of FFELP loans subject to risk-sharing.

Through October 2005, to assess the appropriate level of the allowance for loan losses, TEFFC adhered to an internal review process with an established methodology to evaluate its loans for impairment. The allowance reflected statistically derived loss probabilities associated with current portfolio attributes, combined with management's judgment of the impact of macroeconomic and other external factors on loan losses. Current portfolio attributes included but were not limited to the size and credit condition of the loan portfolio, exhibited borrower behavior, loan age, historical loss experience, and levels and trends of certain loan delinquencies.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

Allowance for Loan Losses (continued)

At December 31, 2006, substantially all of TEFFC's FFELP loans had been sold to a third party, Nelnet. Approximately \$1.0 million of FFELP loans that were more than 210 days delinquent remained on TEFFC's books at December 31, 2006. These delinquent loans will eventually flow through the defaulted loan process or become eligible for sale without premium to Nelnet as they become less than 210 days delinquent. Subsequent to the loan sale in October 2005, the allowance process for these few remaining FFELP loans has been refined due to the small number of loans involved and the uniformity of risk profiles.

The CEL loans held in the CalEdge bond were not included in the asset sale. The CEL allowance process is now administered by CALMA under the CalEdge management and administration agreement. TEFFC and CALMA periodically assess the recoverability of the portfolio and calculate an allowance to provide for probable net losses on the remaining CEL loans.

Interest Expense and Financing Costs

Interest expense is based upon contractual interest rates adjusted for the amortization of deferred financing costs. Financing costs incurred when establishing financing arrangements are capitalized and amortized over the term of the financing arrangement as a component of interest expense. TEFFC's total amortization of deferred financing costs for the years ended December 31, 2006 and 2005 was \$0.2 million and \$0.9 million, respectively.

Student Loan Program Expenses

Student loan program expenses include all other third-party costs directly attributable to the management of trust assets and liabilities. Major program expenses are origination fees paid to the DOE, bond broker/dealer fees, trustee fees, professional service provider fees, excess loan yield, and arbitrage rebate expenses.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

Income Taxes

TEFFC's predecessors, Resources and Chela, Inc., have each been previously notified by both the IRS and the State of California, respectively, that they qualify for exemption from income tax (except for income tax on any unrelated business income) under IRS Code Section 501(c)(3) and California Revenue and Taxation Code Section 23701(d).

Additionally, in March 2006, TEFFC was notified by the IRS that an examination was performed of Resources for the 2002 tax year, and that the organization continued to qualify for exemption from Federal income tax, and the respective Form 990 return was accepted as filed. TEFFC, formerly Chela Inc., maintains its IRS Code Section 501(c)(3) organization status.

As a newly created for-profit Delaware corporation, CEFI uses the liability method to account for income taxes. Under this method, deferred income tax assets and liabilities are based on the differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized (refer to Note 14, Income Taxes).

Allowance for Excess Loan Yield and Investment Arbitrage Rebates

The IRC, as amended, required that TEFFC subsidiaries calculate and remit amounts deemed by the IRC to be excess yields earned on (a) non-purpose investments (arbitrage rebates) and (b) FFELP student loan investments (excess loan yield) acquired with proceeds of tax-exempt bond or note financings. Both calculations are based on the excess of investment yield over the related bond or note cost of funds. Arbitrage rebate, if any, is paid at each five-year anniversary of the underlying bond's issuance date and at bond maturity. Excess loan yield liability, if any, is paid at final maturity of the underlying bond. TEFFC accrued a liability for these amounts and recognized income or expense related to changes in these liabilities based on third-party calculations as of the balance sheet dates.

As discussed in Note 2, on October 25, 2005, TEFFC defeased all of its tax-exempt bond financings and fully satisfied its bond obligations along with its excess loan yield liabilities concurrent with the sale of student loan receivables to Nelnet. Thus, at December 31, 2006 and 2005, TEFFC had no excess loan yield liabilities outstanding.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

Grants

Conditional grants, which depend on the occurrence of a specified future and uncertain event to bind TEFFC, are recognized when the conditions on which they depend are substantially met. Unconditional grants are recognized as grant expense and liability when TEFFC approves the unconditional grant. Unconditional grants that are expected to be paid in less than one year are measured at net settlement value. Unconditional grants that are expected to be paid in more than one year are measured at the present value of the estimated future cash flows. No conditional grants have been made by TEFFC.

Derivative Instruments

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its amendments, SFAS No. 137, No. 138, and No. 149, which require that all derivative instruments be recorded on the balance sheet as either assets or liabilities measured at fair value. Derivatives that are not designated as hedges under SFAS No. 133, as amended, must be adjusted to fair value through income. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of the assets or liabilities through earnings or are recognized as a change in net assets in the period of change. For a derivative designated as a hedge, the ineffective portion of its change in fair value will be immediately recognized in earnings.

Derivative instruments were used in the past to moderate earnings exposure to changes in absolute interest rate levels and interest rate spreads between indices. With the sale of substantially all of its loan portfolio assets, all derivative instruments had expired or been canceled by December 31, 2006.

TEFFC had not designated any derivatives as hedges under SFAS No. 133. Thus, changes in derivative instrument fair values were reported as a component of interest expense.

At no time did TEFFC enter into derivative contracts for the purpose of speculation. Derivatives with positive fair values are reported as a component of other assets. Derivatives with negative fair values are reported as a component of accounts payable and accrued liabilities.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

4. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

On July 13, 2006, the FASB released FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. FIN No. 48 requires the evaluation of tax positions taken, or expected to be taken, in the course of preparing TEFFC's and its subsidiaries' tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would not be recorded as a tax benefit or expense in the current year. Adoption of FIN No. 48 is required for fiscal years beginning after December 31, 2006 and is to be applied to all open tax years as of the effective date. TEFFC is currently evaluating the impact that FIN No. 48 may have on its future financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This standard clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. As of the date of these financial statements, TEFFC does not believe the adoption of SFAS No. 157 will impact the amounts reported in the financial statements; however, additional disclosures will be required about the inputs used to develop the measurements of fair value and the effect of certain measurements reported in the Consolidated Statement of Activities and Changes in Net Assets for a fiscal period.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current presentation.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

5. Trust Indenture Restrictions

Under the provisions of the AICPA *Audit and Accounting Guide for Not-for-Profit Organizations* and related standards, net assets, revenues, expenses, gains, and losses are reported based on the existence or absence of donor-imposed restrictions. At December 31, 2006 and 2005, the net assets of TEFFC are not subject to any donor-imposed restrictions and are reported as “Unrestricted Net Assets.” The only limits on unrestricted net assets are those resulting from TEFFC’s trust indentures, the purposes specified in its articles of incorporation or bylaws, and limits resulting from other contractual agreements. TEFFC’s trust indentures under which bonds and notes are issued or the asset-backed credit line restrict the transfer of trust funds to the general operating account until the ratio of trust asset collateral to bond liability or indebtedness meets or exceeds specified distribution thresholds.

Asset collateral held in trusts in excess of bond and notes liability or indebtedness, but not available for distribution due to asset collateral ratio threshold restrictions, was approximately \$0.4 million and \$22.9 million at December 31, 2006 and 2005 respectively.

6. Investments

On April 5, 2005, the Board of Directors of the Foundation delegated authority to the Investment Committee of the Board to develop the Foundation’s investment policy and objectives and to allocate and direct the investment of Foundation funds. The Investment Committee reports to the Board of Directors on a quarterly basis. At December 31, 2006 and 2005, the Foundation had investments in the following categories, totaling \$419.8 million and \$215.3 million, respectively: fixed income and bond funds, diversified inflation hedge fund, domestic equity funds, marketable alternative funds, and international equity funds. The diversified inflation hedge fund includes a wide variety of investments, such as domestic and international equities, fixed income securities, commodities futures, and real estate investments. Additionally, the CalEdge student loan and bond program had guaranteed investment contracts totaling \$2.1 million and \$2.6 million at December 31, 2006 and 2005, respectively.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

6. Investments (continued)

During 2006, TEFFC investments consisted of guaranteed investment contracts, U.S. government debt, U.S. government agency debt, corporate debt, fixed income securities, commodity futures, real estate investments, and domestic and international equity securities.

TEFFC's investments at December 31, 2006 and 2005 held by the trustees, agents of the trustees, and other financial institutions were as follows:

	2006	2005
	<i>(In Thousands)</i>	
Guaranteed investment contracts (CalEdge Program)	\$ 2,074	\$ 2,615
Fixed income and bond funds	80,638	52,338
Diversified inflation hedge fund	58,911	27,637
Domestic equity funds	125,346	92,730
International equity funds	91,138	42,605
Marketable alternatives	63,741	–
Total investments	\$ 421,848	\$ 217,925

The guaranteed investment contracts held by TEFFC at December 31, 2006 mature in 2010, 2028, and 2031 and include provisions requiring the issuer to provide collateralization in the form of U.S. government obligations. The guaranteed investment contracts held by TEFFC were issued by GE Capital Corporation.

Investment income for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005
	<i>(In Thousands)</i>	
Interest and dividends	\$ 10,447	\$ 17,247
Realized gains	1,907	1,220
Unrealized gains	42,369	4,859
Total investment income, net	\$ 54,723	\$ 23,326

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

7. Student Loans Receivable

At December 31, 2006 and 2005 student loans receivable consisted of the following:

	2006	2005
	<i>(In Thousands)</i>	
FFELP student loans receivable	\$ 982	\$ 60,532
Consumer education loans receivable	10,590	108,921
Accrued interest and other receivables	1,202	12,613
Deferred loan premiums, transfer fees, and origination costs, net of accumulated amortization	3	645
	12,777	182,711
Allowance for loan losses	(599)	(6,716)
Student loans receivable, net	\$ 12,178	\$ 175,995

FFELP Program

FFELP student loans receivable is comprised of federally guaranteed student loans with DOE-specified interest rate formulas and repayment terms. TEFFC's FFELP student loans receivable consist of loans originated under the provisions of the FFELP. The FFELP programs are the Federal Stafford Loan (Stafford) Program, the Federal Supplemental Loans for Students (SLS) Program, the Federal Parent Loan for Undergraduate Students (PLUS) Program, and the Federal Consolidation Loan Program. These loan programs are generally available to eligible students and parents of students who were enrolled in post-secondary education institutions.

FFELP loans obligate the borrower to pay interest at a stated fixed rate or a variable rate that has a maximum rate. Variable borrower interest rates reset annually on July 1, at levels dependent on loan type, status, loan origination date, and prevailing interest rates. TEFFC earns interest at the greater of the borrower's rate or a DOE-specified SAP rate. If the SAP rate exceeds the borrower rate, the DOE makes a payment directly to TEFFC equal to the excess of the SAP rate over the borrower rate. The SAP rate varies by product type, status, loan disbursement date, and funding source. The SAP rate formula floats with a reference index rate (91-day Treasury bill, 3-month commercial paper, or 52-week Treasury bill) plus a spread of between 1.74 and 3.50 percentage points. Loans funded with tax-exempt debt originally issued prior to October 1, 1993, or direct refinancings or refundings thereof, are subject to a 9.5% minimum SAP rate.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

7. Student Loans Receivable (continued)

FFELP Program (continued)

FFELP loans held by TEFFC have been guaranteed by eligible guarantors against the borrower's default, death, disability, or bankruptcy. FFELP loans originated prior to October 1, 1993 are guaranteed at 100%, while FFELP loans originated on or after October 1, 1993 are guaranteed at 98% or 100%. All FFELP loans are reinsured by the DOE under the Higher Education Act of 1965, as amended, provided applicable program requirements have been met by the originating lender with respect to such loans.

In the event of a FFELP student loan default, TEFFC files a claim with the guarantor of the loan. TEFFC will receive the unpaid principal balance and accrued interest on the loan less risk-sharing, if applicable, provided the loan has been properly originated and serviced.

Third parties who have sold FFELP loans to TEFFC warranted that the student loans were originated in accordance with program requirements and were valid obligations of the borrowers. In the event that student loans do not conform to the terms of the purchase agreement between TEFFC and the third-party seller, the loans may be returned to the third-party seller for reimbursement of principal and accrued interest. During the years ended December 31, 2006 and 2005, no material loan amounts were returned to third-party sellers.

At December 31, 2006, TEFFC had no outstanding loan purchase obligations under forward purchase agreements or contingent loan purchase obligations from prior purchase agreements. All such agreements were assumed by Nelnet as part of the sale of FFELP student loan receivables in October 2005.

Throughout 2006, pursuant to the terms and conditions of the APA, CEFI and Nelnet identified adjustments that required one party to make payments to the other. At year-end 2006, the parties had reached agreement on seven adjustment items, requiring a \$1.7 million payment by CEFI to Nelnet. This amount has been accrued as a component of accounts payable and accrued liabilities in the Consolidated Statements of Financial Position at December 31, 2006 and 2005. The amount was recorded as a reduction to the gain on sale of loans and other assets in the 2005 consolidated statements of activities and changes in net assets. CEFI settled the amounts due to Nelnet on June 26, 2007.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

7. Student Loans Receivable (continued)

FFELP Program (continued)

In August 2006, Nelnet discovered an error in its software system that produces the data file used by the DOE to calculate SAP and government interest payments for CEFI. The impact of this error was to understate the amount of SAP income for three quarters, beginning with the fourth quarter 2005 through and including the second quarter 2006. Nelnet made a partial correction to the DOE filing in the third quarter 2006, which approximately produced a \$77,000 payment to CEFI.

The balance of the correction was processed in the fourth quarter 2006 DOE filing. At December 31, 2006, CEFI estimated that the SAP income it was due amounted to approximately \$0.7 million and reflected this amount as due from the DOE on its consolidated statements of financial position. The amount has been recorded as an increase to student loan interest, including special allowance payments, in the consolidated statements of activities and changes in net assets. The DOE reviewed the filing and paid CEFI \$0.8 million in the second quarter 2007 (refer to Note 3).

Student Loan Receivable Held for Sale

As part of the agreements entered into with Nelnet, TEFFC committed to sell to Nelnet loans that were partially disbursed or loans to be disbursed under applications that were in process (Pipeline Loans). For those loans to be first disbursed within the 90 days following the October 25, 2005 initial loan sale to Nelnet, a premium would be paid on the full disbursement amount regardless of the timing of subsequent disbursements. Under the terms of a Participation Loan Sale Agreement, Nelnet contracted to fund these Pipeline Loans until sold to Nelnet several months after final disbursement. At December 31, 2005, the principal balance of such funded participation loans totaled \$181.8 million. Both an asset and corresponding liability is recorded for these participation loans. There are no participation loans at December 31, 2006.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

7. Student Loans Receivable (continued)

CEL Program

TEFFC continues to hold the CalEdge portfolio. All other CEL loans were sold on June 8, 2006 as mentioned in Note 3.

In 2005, TEFFC's CEL portfolio consisted of loans originated or purchased under various programs. Loans under The Education Resources Institute, Inc. (TERI) program were guaranteed by TERI, a private loan guarantor. Loans receivable under the TERI program at December 31, 2005 approximated \$16.8 million. Under certain other loan programs, TEFFC receives guarantee fees that are included in the allowance for loan losses. Guarantee fees are used to offset losses associated specifically with these loan programs.

Combined FFELP and CEL Programs

At December 31, 2006, TEFFC maintained third-party servicing agreements with four corporations to act as agents for the FFELP and CEL programs to perform loan servicing, billing, accounting, reporting, and loan administrative duties. Under the terms of the servicing agreements, the servicers are held liable for losses resulting from their own negligent loan servicing. At December 31, 2006 and 2005, 100% of TEFFC's loans were serviced by third-party servicers.

8. Allowance for Loan Losses

The table below summarizes the changes in the allowance for loan loss reserve for the years ended December 31, 2006 and 2005:

	2006	2005
	<i>(In Thousands)</i>	
Balance at the beginning of the year	\$ 6,716	\$ 6,428
Provision for possible losses	771	1,336
Allowance reduction due to loan sale	(5,927)	(297)
Charges to allowance	(1,867)	(2,214)
Recoveries and other	906	1,463
Balance at end of the year	\$ 599	\$ 6,716

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

9. Grants Payable

The following is a schedule of future grant payments required under current grants at December 31, 2006:

	<u>2006</u>
	<i>(In Thousands)</i>
2007	\$ 2,353
2008	225
Total	<u>\$ 2,578</u>

10. Bonds and Note Payable

TEFFC had one note payable outstanding as of December 31, 2006 totaling \$11.1 million. The note payable to CEFA is related to the CALEDGE program.

The CEFA note payable is in connection with a tax-exempt financing and is payable at a fixed rate of 5.55% and matures in 2028.

11. Asset-Backed Lines of Credit

As mentioned in Note 2 above, on June 8, 2006, TEFFC consummated a sale of the remaining \$93.0 million consumer education loan (CEL loan) portfolio. Concomitant with this transaction, the Amended and Restated Indenture dated January 31, 2005 between CNAI and Chela Funding II, LLC was terminated.

As of December 31, 2005, TEFFC had a \$175 million student loan asset-backed commercial paper line of credit, made available through CNAI, as agent. This line of credit was available for the financing of FFELP or CEL with a maximum limit for CEL of \$120 million. At December 31, 2005, \$113 million of borrowings were outstanding under this facility.

Effective February 15, 2006, this line limit was reduced from \$175 million to \$125 million. This facility was then renewed effective April 4, 2006 to April 3, 2007, with a \$100 million line limit, unrestricted as to availability for either FFELP or CEL financings. The line was terminated when the CEL loan portfolio was sold in June 2006.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

11. Asset-Backed Lines of Credit (continued)

Interest rates on borrowings were at spreads over the prevailing commercial paper rate for Prime-1 rated commercial paper. There was a liquidity fee paid on this facility, independent of the level of utilization, as well as commercial paper dealer fees. This facility contained various financial covenants, including minimum collateral ratio requirements. TEFFC was in compliance with these financial covenants at December 31, 2005.

12. Derivative Instruments

At December 31, 2005, TEFFC was party to the following derivative contract:

Derivative product:	Treasury/LIBOR index swap
Payment formula:	TEFFC pays prevailing 91-day Treasury bill rate + 66 basis points TEFFC receives prevailing 1-month LIBOR
Notional value:	\$30.41 million
Amortization:	Indexed to 1998A financing trust outstanding loan portfolio
Fair value:	\$10 thousand payable
Maturity:	April 26, 2010

There were no derivative contracts outstanding at December 31, 2006.

13. Employee Benefits

TEFFC sponsors a 403(b) plan to which eligible employees may voluntarily contribute a percentage of their compensation. TEFFC contributes a matching amount up to 6% of an employee's salary. CEFI sponsored a 401(k) plan which was terminated on January 18, 2007. TEFFC's plan expense was \$33 thousand for the year ended December 31, 2006.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

13. Employee Benefits (continued)

CEFI also has a nonqualified deferred compensation plan (the DCP) established to provide specified benefits to a select group of management. Contribution, vesting, and benefit provisions are as outlined in the plans. In May 2005, CEFI funded the DCP plan using corporate-owned life insurance carried by Sun Life Assurance Company of Canada (U.S.), owned by a Rabbi Trust through Wilmington Trust Bank. At December 31, 2006, the cash surrender value of this life insurance policy was \$1.0 million. The deferred compensation liability was \$1.0 million, and the deferred compensation expense for 2006 was \$0.5 million. The following table sets forth the DCP status, along with amounts recognized in TEFFC's consolidated statements of financial position for the years ended December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Reconciliation of DCP cost:		
Accrued DCP cost at beginning of year	\$ (1,553,812)	\$ (1,166,020)
Net periodic DCP credit	(97,332)	(220,344)
Plans' participant contributions	(440,383)	(950,957)
Benefits paid	<u>1,127,814</u>	<u>783,509</u>
Accrued DCP cost at end of year	(963,713)	(1,553,812)
Cash surrender value of insurance policy	<u>1,008,905</u>	1,696,860
Over funded/(under funded) status	<u>\$ 45,192</u>	<u>\$ (56,972)</u>

14. Income Taxes

As a result of the restructuring discussed in Note 2, CEFI, a for-profit Delaware corporation, was created. Because CEFI incurred a taxable net loss in both 2005 and 2006, there is no current income tax expense for those years.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

14. Income Taxes (continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of CEFI's deferred tax liabilities and assets at December 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Deferred tax assets:		
Accrued liabilities	\$ 459,750	\$ 886,109
Deferred installment sale loss	2,408,950	5,896,672
Tax loss carryforwards	4,283,421	1,255,593
Other	96,455	141,340
Net deferred tax assets	<u>7,248,576</u>	<u>8,179,714</u>
Valuation allowance	<u>(7,248,576)</u>	<u>(8,179,714)</u>
Net deferred taxes	<u>\$ -</u>	<u>\$ -</u>

CEFI has provided a full valuation allowance on the net deferred tax assets due to uncertainties regarding the realization of deferred tax assets based on CEFI's lack of earnings history and nominal projected future earnings. The valuation allowance decreased by \$931,000 during 2006.

CEFI, on a stand-alone reporting basis apart from the Foundation, incurred a deferred tax expense of \$18.6 million in 2005 relating to the realization of certain deferred tax assets upon the Nelnet loan sale. The deferred tax assets were created in the intracompany restructuring. Accordingly, the \$18.6 million expense was eliminated upon consolidation of the Company. No future tax liability exists with respect to the realization of these deferred tax assets.

As of December 31, 2006, CEFI had federal net operating loss carryforwards of approximately \$10.5 million. The net operating loss carryforwards will expire beginning in 2025 if not utilized.

Utilization of net operating losses may be subject to a substantial annual limitation due to the "change of ownership" provisions of the Internal Revenue Code of 1986. The annual limitation may result in the expiration of net operating losses before utilization.

CEFI's provision for income taxes differs from the expected tax benefit amount computed by applying the statutory federal income tax rate of 34% to loss before income taxes primarily due to the increase in the valuation allowance.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments

SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, requires an estimation of fair values of TEFFC's financial instruments. The following is a summary of the assumptions and methods used to estimate those values.

Cash and Equivalents

Fair value approximates carrying value based on the liquidity and short-term nature of the instruments.

Investments

Fair value for investments with short-term remaining maturities (less than three months) is approximately carrying value. The fair value of variable-rate guaranteed investment contracts approximates carrying value, as the underlying interest rate of these investments over the anticipated holding period approximates current market rates. The fair value of the fixed-rate investment contracts is estimated using discounted cash flow analyses, using then-prevailing market interest rates. The carrying value for the remaining investments, principally debt and equity securities, approximates fair value, as taken from market prices reported in brokerage and investment manager account statements.

Student Loans Receivable and Student Loans Receivable Held for Sale

The fair value of student loans receivable, with the exception of certain fixed-rate loans, is deemed to be their carrying value. The fair value for fixed-rate loans is estimated using discounted cash flow analyses, using then-prevailing market interest rates.

Bonds and Notes Payable, Asset-Backed Lines of Credit

The fair value approximates the carrying value, as bonds, notes, and asset-backed lines of credit obligation interest rates are principally variable rates that regularly adjust to levels consistent with prevailing market interest rates. For fixed-rate bonds and notes, the fair value is estimated using discounted cash flow analyses using then-prevailing market interest rates.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments (continued)

Bonds and Notes Payable, Asset-Backed Lines of Credit (continued)

The following table summarizes the fair value of TEFFC's financial instruments as of December 31, 2006:

	Carrying Value	Fair Value
	<i>(In Thousands)</i>	
Assets		
Cash and equivalents	\$ 19,014	\$ 19,014
Investments	421,848	421,861
Student loan receivables*	10,976	11,434
Liabilities		
Bonds and note payable	11,145	11,291

* The carrying value for student loans receivable includes net unamortized purchase premiums and origination costs, and allowance for loan losses, but excludes accrued interest receivable.

16. Commitments, Contingencies, and Concentrations of Risk

Premises and Equipment Lease Commitments

In late 2006, TEFFC entered into a five-year lease agreement for new office space with a commencement date of February 2007. The lease on its original office space has a termination date of July 2010. Simultaneously with its entering into the new lease, TEFFC sublet its original office space for the remainder of its term.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

16. Commitments, Contingencies, and Concentrations of Risk

Premises and Equipment Lease Commitments

The following is a schedule of future minimum rental payments required under operating leases, including TEFFC's office facilities and equipment that have remaining noncancelable terms in excess of one year at December 31, 2006:

2007	\$ 390,340
2008	337,736
2009	342,060
2010	303,221
2011	243,810
2012	40,166
Total	<u>\$ 1,657,333</u>

The total sublease income specified in the sublease agreements is as follows:

2007	\$ 179,389
2008	118,990
2009	118,990
2010	69,410
Total	<u>\$ 486,779</u>

Total rental expense for the years ended December 31, 2006 and 2005 was \$0.6 million and \$0.8 million respectively. Rental expense includes the lease on CEFI's office premises through April 17, 2006. The lease termination date was originally April 16, 2009. However, CEFI exercised an option to cancel the lease and paid a termination fee of \$71,091. CEFI sublet this space through the time that the lease was terminated.

17. Contingencies and Concentrations of Risk

From time to time, TEFFC may be involved as a party to certain legal proceedings and other claims arising in the normal course of its business. While litigation and claims resolution are subject to many uncertainties and cannot be predicted with assurance, it is management's opinion that any resulting losses would not have a material effect on TEFFC's financial statements.

The Education Financing Foundation of California

Notes to Consolidated Financial Statements (continued)

17. Contingencies and Concentrations of Risk (continued)

TEFFC is subject to significant regulations and administrative rules imposed by various regulatory bodies. These rules and regulations are subject to legislative changes and departmental interpretation that may change over time. It is possible that future legislative changes or interpretations of administrative rules and regulations may result in changes to TEFFC's financial position.

TEFFC's credit risk is inherent principally in its investments. Adverse economic conditions either nationwide or internationally may result in a reduction of the investments carrying amount. The maximum loss on the investments would be the carrying amount in the financial statements.

TEFFC's credit risk is also inherent in its student loans receivable. Adverse economic conditions either regionally or nationwide may result in an increase in student loan borrower defaults.