

# **City of Scottsbluff, Nebraska**

**Monday, December 21, 2015**

**Regular Meeting**

## **Item Reports2**

**Council to consider approval of the request from Allo Communications to consent to the acquisition by Nelnet of a controlling interest in Allo and approve the Resolution.**

**Staff Contact: Rick Kuckkahn, City Manager**



December 3, 2015

City of Scottsbluff  
2525 Circle Drive  
Scottsbluff, NE 69341  
Attn: City Clerk

Re: Allo Twin Cities LLC Change of Control

Dear Sir or Madam:

Allo Communications LLC ("Allo") is the parent company of Allo Twin Cities LLC ("Allo Twin Cities"). Allo Twin Cities is the holder of a cable television franchise from the City pursuant to the Franchise Agreement dated January 19, 2010.

As you may have seen in press reports, Allo's owners have entered into an agreement to sell 92.5% of their existing equity interests in Allo (the "Transaction") to Nelnet, Inc., a Nebraska corporation ("Nelnet"). As a result of the Transaction, Nelnet will become the *direct* majority owner of Allo and the *indirect* majority owner of Allo Twin Cities. Upon conclusion of the Transaction, your local franchisee will remain the same (Allo Twin Cities) and will have the same parent company (Allo), but ultimately will be owned by Nelnet and management rather than the current group of approximately forty investors and management.

Attached as Attachment 1 is basic information about the parties and the Nelnet transaction. Attached as Attachment 2 are Nelnet's audited financial statements for calendar year 2014 as reported to the Securities and Exchange Commission.

We respectfully request that you provide your consent to the indirect change of ownership of Allo Twin Cities and are providing information about the Transaction and Nelnet to help facilitate the consent process. Attached are materials to provide you with the relevant information needed to assess the financial, legal, and technical qualifications of Nelnet to be the ultimate parent entity of your franchisee.

All of us at Allo are excited about the opportunity to expand our network and build an even stronger company with the financial resources and support of Nelnet. If you have any questions about the enclosed documents and information, please give me a call at (308) 633-7802, or send an email to [bmoline@allophone.net](mailto:bmoline@allophone.net).

Sincerely,

A handwritten signature in blue ink, appearing to read "B. A. Moline".

Bradley A. Moline  
President, Allo Twin Cities LLC and Allo Communications LLC

cc: Rick L. Ediger, Simmons Olsen Law Firm, P.C.

## ATTACHMENT 1

### Application for Consent to the Indirect Transfer of Control of Allo Twin Cities LLC to Nelnet, Inc.

<b><i>Franchisee</i></b>  Allo Twin Cities LLC 1721 Broadway, Suite 200 Scottsbluff, NE 69361	<b><i>Transferee of Control</i></b>  Nelnet, Inc. 121 South 13 <sup>th</sup> Street, Suite 201 Lincoln, NE 68508
<b><i>Parent Company of Franchisee</i></b>  Allo Communications LLC 610 Broadway St. Imperial, NE 69033	
<b><i>Contact Information for Franchisee and Parent with Respect to the Transaction</i></b>  Bradley A. Moline, President Allo Twin Cities LLC Allo Communications LLC 610 Broadway St. Imperial, NE 69033 308.882.7800 (phone) 308.882.7850 (fax) <a href="mailto:bmoline@allophone.net">bmoline@allophone.net</a>	<b><i>Transferee Contact Information</i></b>  William J. Munn General Counsel Nelnet, Inc. 3015 S. Parker Rd. Suite 400 Aurora, CO 80014 303.696.5405 (phone) 402.458.2294 (fax) <a href="mailto:bill.munn@nelnet.net">bill.munn@nelnet.net</a>

#### ***Description of the Transaction***

Allo is a Nebraska-based telecommunications company founded in 2003 that offers competitive local telephone, long distance, broadband, Internet, and television services to homes and businesses across Nebraska. It currently provides communications services to over 20 cities in the state through a combination of its own switching and fiber optic network, leased facilities, and some resold services. It began building a state-of-the-art fiber optic network in 2004, and currently provides gigabit fiber Internet service in Scottsbluff, Gering, Bridgeport, North Platte, Ogallala, and Alliance.

Headquartered in Lincoln, Nebraska, Nelnet is one of the leading education planning and education finance companies in the United States and provides innovative educational services in loan servicing, payment processing, education planning, and asset management for families and educational institutions. Nelnet is traded on the New York Stock Exchange. Nelnet takes a

comprehensive approach to the education life-cycle, which through the proposed transaction will include the advanced communications networks that have become central to learning and succeeding.

Nelnet, Allo, and the current equity owners of Allo entered into a Membership Unit Purchase Agreement dated November 16, 2015 (the "Agreement"). Pursuant to the Agreement, Nelnet will acquire 92.5 percent of the equity and membership units of Allo, which will become a direct subsidiary of Nelnet. The remaining 7.5 percent of the equity and membership interests of Allo will be owned by Allo management, who will also have the opportunity to earn additional equity (up to 20 percent overall) based on the performance of the company. Because only the owners of Allo's equity will change, Allo will continue to provide high quality broadband, telecommunications, and video services to Nebraskans.

The proposed Transaction will serve the public interest by combining two Nebraska-based companies that share a commitment to delivering an exceptional customer experience with great service and best-in-class technology. Allo has developed a world-class regional competitive network that expands business opportunities, creates jobs, and improves quality of life for Nebraskans. The transaction will provide Allo with additional funding and resources that will help support the expansion of Allo's fiber optic network in Nebraska. Indeed, the parties anticipate expanding Allo's network in additional areas of its current markets as well as to new markets, including Lincoln, the location of Nelnet's headquarters. This planned expansion in turn will benefit residential, business, and governmental customers throughout the state, who will have access to a competitive provider of dependable communications solutions and ultra-fast Internet services. The transaction will also promote competition by creating a stronger company that can more effectively compete in the telecommunications marketplace.

### ***Managerial, Technical and Financial Resources***

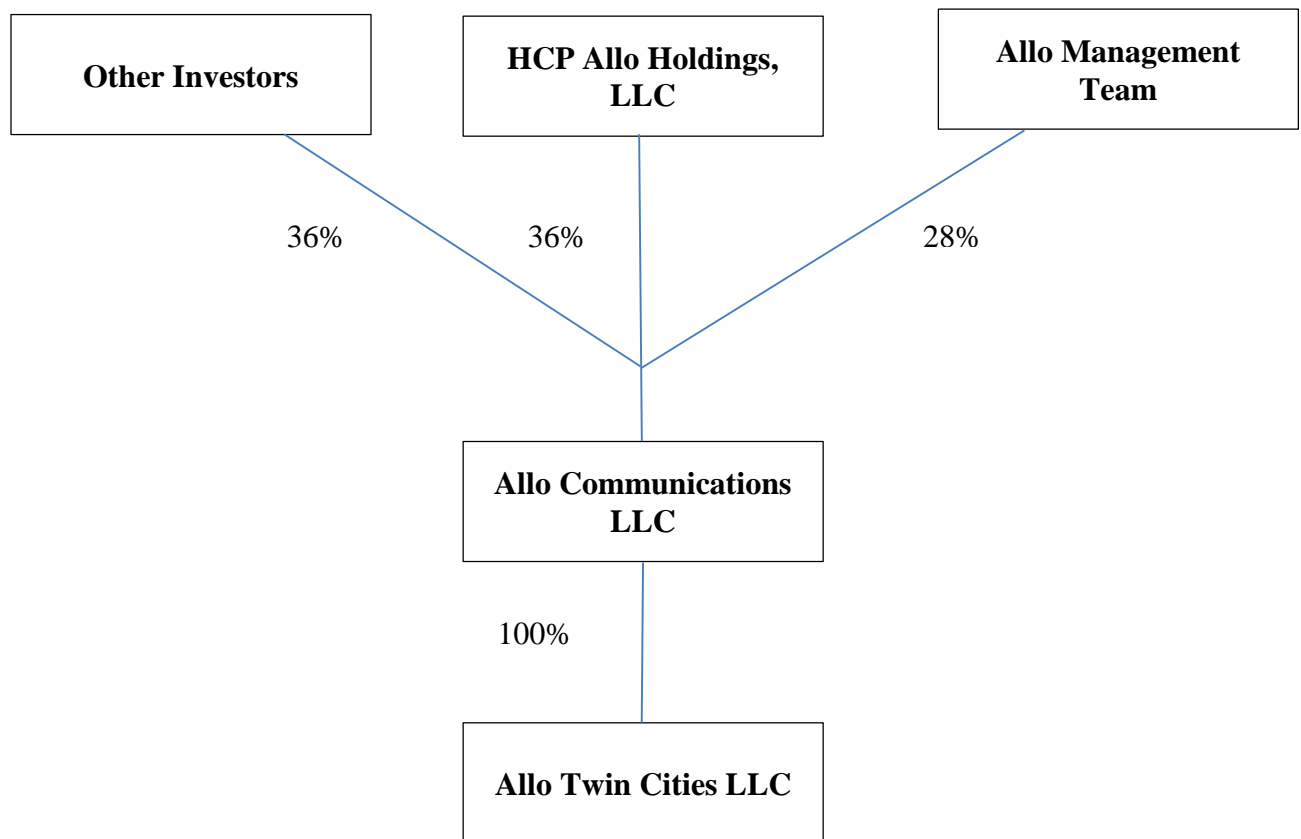
There will be no change in the day-to-day management and operations of Allo Twin Cities or Allo as a result of the Transaction. Brad Moline, the founder of Allo, will remain the President of Allo and Allo Twin Cities. Jeff Kuenne, Allo's Executive Vice President, will continue to lead Allo's network engineering and operations.

Moline and Kuenne currently serve as two members of Allo's six-member Board of Managers (with the other four managers consisting of representatives of Allo's approximately forty investors). Following the closing of the Transaction, Moline and Kuenne will continue to serve as two members of the five-member Board of Managers, with the other three managers appointed by Nelnet. Moline and Kuenne will both continue to own equity in Allo following the consummation of the Transaction. All management, technical and other employees of Allo will continue to hold their current positions following the Transaction.

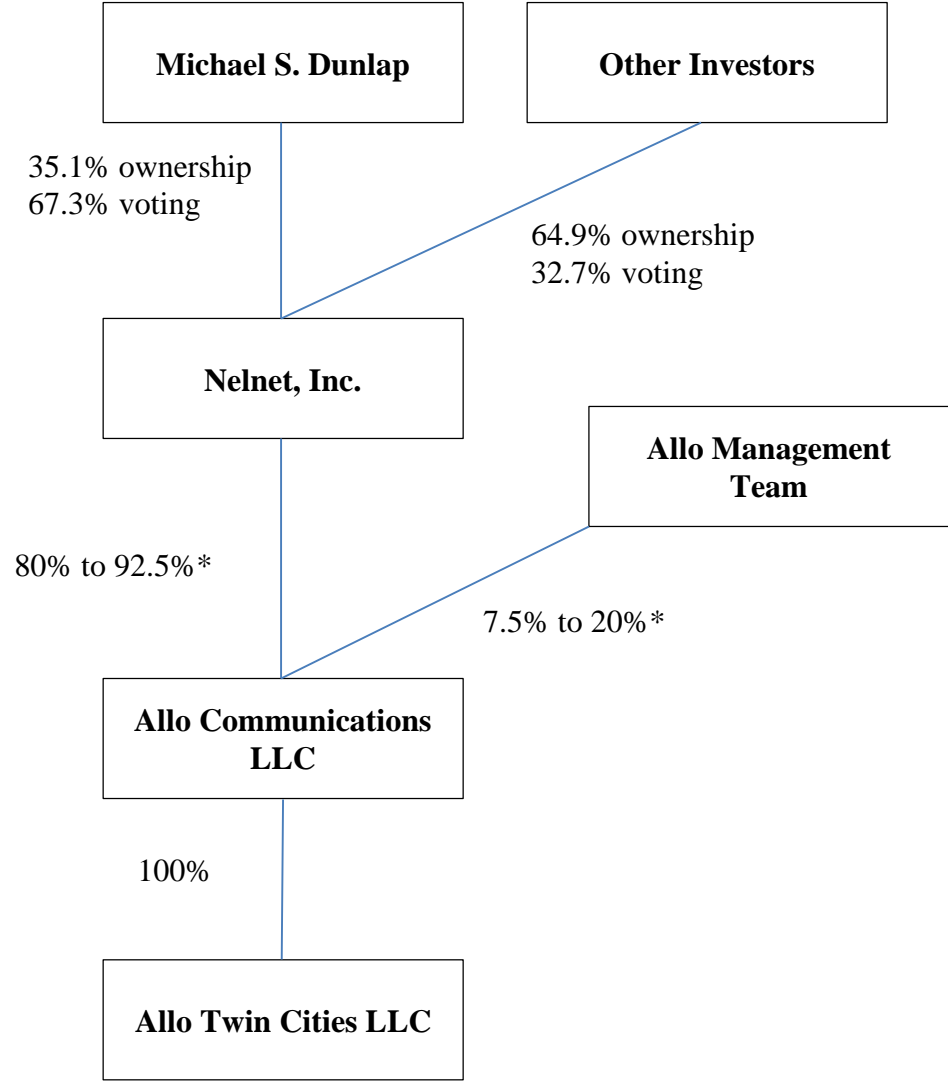
Nelnet's majority ownership will provide Allo and Allo Twin Cities with additional financial resources and financial strength. Nelnet is publicly traded on the New York Stock Exchange. As of November 25, 2015, Nelnet's market capitalization was \$1.4 billion. Attached as Attachment 2 are Nelnet's audited financial statements for calendar year 2014 from its annual report on Form 10-K as filed with the United States Securities and Exchange Commission on February 26, 2015.

Nelnet's Class A common stock, which provides holders with one vote per share, is publicly traded. Nelnet's Class B common stock, which provides holders with ten votes per share, is not publicly traded. According to Nelnet's Definitive Proxy Statement filed with the SEC on April 2, 2015, at the close of business on March 19, 2015, there were 34,735,426 shares of Nelnet's Class A common stock outstanding and 11,486,932 shares of the Company's Class B common stock outstanding. According to the Proxy Statement, Michael S. Dunlap, Nelnet's executive chairman and a resident of Lincoln, Nebraska, owned 6,805,061 shares of Class A common stock and 9,381,829 shares of Class B common stock, representing ownership of 35.1% of all outstanding Nelnet common stock and 67.3% of the voting power of all classes of common stock.

**Allo Communications LLC  
Pre-Closing Ownership Structure**



**Allo Communications LLC  
Post-Closing Ownership Structure**



\* Allo Management will own 7.5% of the equity of Allo at the time of the closing of the Transaction and will be provided the opportunity to earn up to 20% of the equity based on achievement of performance goals.

**ATTACHMENT 2**  
**NELNET, INC. AND SUBSIDIARIES**  
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## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Nelnet, Inc.:

We have audited the accompanying consolidated balance sheets of Nelnet, Inc. and subsidiaries (the Company) as of December 31, 2014 and 2013 , and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014 . These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 financial position of Nelnet, Inc. and subsidiaries as of December 31, 2014 and 2013 , and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014 , in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Nelnet, Inc.'s internal control over financial reporting as of December 31, 2014 , based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 26, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Lincoln, Nebraska  
February 26, 2015

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**NELNET, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**December 31, 2014 and 2013**

	<b>2014</b>	<b>2013</b>
	(Dollars in thousands, except share data)	
<b>Assets:</b>		
Student loans receivable (net of allowance for loan losses of \$48,900 and \$55,122, respectively)	\$ 28,005,195	25,907,589
Cash and cash equivalents:		
Cash and cash equivalents - not held at a related party	37,781	8,537
Cash and cash equivalents - held at a related party	92,700	54,730
Total cash and cash equivalents	130,481	63,267
Investments	149,123	192,040
Restricted cash and investments	850,440	735,123
Restricted cash - due to customers	118,488	167,576
Accrued interest receivable	351,588	314,553
Accounts receivable (net of allowance for doubtful accounts of \$1,656 and \$3,845, respectively)	50,552	56,072
Goodwill	126,200	117,118
Intangible assets, net	42,582	6,132
Property and equipment, net	45,894	33,829
Other assets	163,208	115,043
Fair value of derivative instruments	64,392	62,507
Total assets	\$ 30,098,143	27,770,849
<b>Liabilities:</b>		
Bonds and notes payable	\$ 28,027,350	25,955,289
Accrued interest payable	25,904	21,725
Other liabilities	167,881	164,300
Due to customers	118,488	167,576
Fair value of derivative instruments	32,842	17,969
Total liabilities	28,372,465	26,326,859
Commitments and contingencies		
<b>Equity:</b>		
Nelnet, Inc. shareholders' equity:		
Preferred stock, \$0.01 par value. Authorized 50,000,000 shares; no shares issued or outstanding	—	—
Common stock:		
Class A, \$0.01 par value. Authorized 600,000,000 shares; issued and outstanding 34,756,384 shares and 34,881,338 shares, respectively	348	349
Class B, convertible, \$0.01 par value. Authorized 60,000,000 shares; issued and outstanding 11,486,932 shares and 11,495,377 shares, respectively	115	115
Additional paid-in capital	17,290	24,887
Retained earnings	1,702,560	1,413,492
Accumulated other comprehensive earnings	5,135	4,819
Total Nelnet, Inc. shareholders' equity	1,725,448	1,443,662
Noncontrolling interest	230	328
Total equity	1,725,678	1,443,990
Total liabilities and equity	\$ 30,098,143	27,770,849
<b>Supplemental information - assets and liabilities of consolidated variable interest entities:</b>		
Student loans receivable	\$ 28,181,244	26,020,629
Restricted cash and investments	846,199	732,771
Fair value of derivative instrument, net	(20,455)	36,834
Other assets	351,934	313,748
Bonds and notes payable	(28,391,530)	(26,244,222)
Other liabilities	(280,233)	(303,142)
Net assets of consolidated variable interest entities	\$ 687,159	556,618



**NELNET, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Income**  
**Years ended December 31, 2014, 2013, and 2012**

	<b>2014</b>	<b>2013</b>	<b>2012</b>
	(Dollars in thousands, except share data)		
Interest income:			
Loan interest	\$ 703,007	638,142	609,237
Investment interest	6,793	6,668	4,616
Total interest income	709,800	644,810	613,853
Interest expense:			
Interest on bonds and notes payable	273,237	230,935	268,566
Net interest income	436,563	413,875	345,287
Less provision for loan losses	9,500	18,500	21,500
Net interest income after provision for loan losses	427,063	395,375	323,787
Other income (expense):			
Loan and guaranty servicing revenue	240,414	243,428	209,748
Tuition payment processing, school information, and campus commerce revenue	98,156	80,682	74,410
Enrollment services revenue	82,883	98,078	117,925
Other income	54,002	46,298	39,476
Gain on sale of loans and debt repurchases, net	3,651	11,699	4,139
Derivative market value and foreign currency adjustments and derivative settlements, net	15,860	18,957	(61,416)
Total other income	494,966	499,142	384,282
Operating expenses:			
Salaries and benefits	228,079	196,169	192,826
Cost to provide enrollment services	53,307	64,961	78,375
Depreciation and amortization	21,134	18,311	33,625
Other	149,990	149,542	128,738
Total operating expenses	452,510	428,983	433,564
Income before income taxes	469,519	465,534	274,505
Income tax expense	160,238	161,193	96,077
Net income	309,281	304,341	178,428
Net income attributable to noncontrolling interest	1,671	1,669	431
Net income attributable to Nelnet, Inc.	\$ 307,610	302,672	177,997
Earnings per common share:			
Net income attributable to Nelnet, Inc. shareholders - basic and diluted	\$ 6.62	6.50	3.76
Weighted average common shares outstanding - basic and diluted	46,469,615	46,570,314	47,369,331

See accompanying notes to consolidated financial statements.

**NELNET, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Comprehensive Income**  
**Years ended December 31, 2014, 2013, and 2012**

	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(Dollars in thousands)		
Net income	\$ 309,281	304,341	178,428
Other comprehensive income:			
Available-for-sale securities:			
Unrealized holding gains arising during period, net	9,006	9,134	10,230
Less reclassification adjustment for gains recognized in net income, net of losses	(8,506)	(5,938)	(5,798)
Income tax effect	(184)	(1,190)	(1,619)
Total other comprehensive income	<u>316</u>	<u>2,006</u>	<u>2,813</u>
Comprehensive income	309,597	306,347	181,241
Comprehensive income attributable to noncontrolling interest	<u>1,671</u>	<u>1,669</u>	<u>431</u>
Comprehensive income attributable to Nelnet, Inc.	<u>\$ 307,926</u>	<u>304,678</u>	<u>180,810</u>

See accompanying notes to consolidated financial statements.

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**NELNET, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Shareholders' Equity**  
**Years ended December 31, 2014, 2013, and 2012**

	Nelnet, Inc. Shareholders											
	Preferred stock shares	Common stock shares		Preferred stock	Class A common stock	Class B common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive earnings	Employee notes receivable	Noncontrolling interest	Total equity
		Class A	Class B									
(Dollars in thousands, except share data)												
Balance as of December 31, 2011	—	35,643,102	11,495,377	\$ —	356	115	49,245	1,017,629	—	(1,140)	—	1,066,205
Issuance of noncontrolling interest	—	—	—	—	—	—	—	—	—	—	5	5
Net income	—	—	—	—	—	—	—	177,997	—	—	431	178,428
Other comprehensive income	—	—	—	—	—	—	—	—	2,813	—	—	2,813
Distribution to noncontrolling interest	—	—	—	—	—	—	—	—	—	—	(431)	(431)
Cash dividends on Class A and Class B common stock - \$1.40 per share	—	—	—	—	—	—	—	(66,237)	—	—	—	(66,237)
Issuance of common stock, net of forfeitures	—	279,834	—	—	3	—	3,913	—	—	—	—	3,916
Compensation expense for stock based awards	—	—	—	—	—	—	2,188	—	—	—	—	2,188
Repurchase of common stock	—	(806,023)	—	—	(8)	—	(22,806)	—	—	—	—	(22,814)
Reduction of employee stock notes receivable	—	—	—	—	—	—	—	—	—	1,140	—	1,140
Balance as of December 31, 2012	—	35,116,913	11,495,377	—	351	115	32,540	1,129,389	2,813	—	5	1,165,213
Issuance of noncontrolling interest	—	—	—	—	—	—	—	—	—	—	5	5
Net income	—	—	—	—	—	—	—	302,672	—	—	1,669	304,341
Other comprehensive income	—	—	—	—	—	—	—	—	2,006	—	—	2,006
Distribution to noncontrolling interest	—	—	—	—	—	—	—	—	—	—	(1,351)	(1,351)
Cash dividends on Class A and Class B common stock - \$0.40 per share	—	—	—	—	—	—	—	(18,569)	—	—	—	(18,569)
Issuance of common stock, net of forfeitures	—	157,684	—	—	2	—	2,377	—	—	—	—	2,379
Compensation expense for stock based awards	—	—	—	—	—	—	3,102	—	—	—	—	3,102
Repurchase of common stock	—	(393,259)	—	—	(4)	—	(13,132)	—	—	—	—	(13,136)
Balance as of December 31, 2013	—	34,881,338	11,495,377	—	349	115	24,887	1,413,492	4,819	—	328	1,443,990
Issuance of noncontrolling interest	—	—	—	—	—	—	—	—	—	—	201	201
Net income	—	—	—	—	—	—	—	307,610	—	—	1,671	309,281
Other comprehensive income	—	—	—	—	—	—	—	—	316	—	—	316
Distribution to noncontrolling interest	—	—	—	—	—	—	—	—	—	—	(1,970)	(1,970)
Cash dividends on Class A and Class B common stock - \$0.40 per share	—	—	—	—	—	—	—	(18,542)	—	—	—	(18,542)
Issuance of common stock, net of forfeitures	—	248,290	—	—	3	—	3,551	—	—	—	—	3,554
Compensation expense for stock based awards	—	—	—	—	—	—	4,561	—	—	—	—	4,561
Repurchase of common stock	—	(381,689)	—	—	(4)	—	(15,709)	—	—	—	—	(15,713)
Conversion of common stock	—	8,445	(8,445)	—	—	—	—	—	—	—	—	—
Balance as of December 31, 2014	—	34,756,384	11,486,932	\$ —	348	115	17,290	1,702,560	5,135	—	230	1,725,678

See accompanying notes to consolidated financial statements.

**NELNET, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**  
**Years ended December 31, 2014, 2013, and 2012**

	2014	2013	2012
	(Dollars in thousands)		
Net income attributable to Nelnet, Inc.	\$ 307,610	302,672	177,997
Net income attributable to noncontrolling interest	1,671	1,669	431
Net income	309,281	304,341	178,428
Adjustments to reconcile net income to net cash provided by operating activities, net of acquisitions:			
Depreciation and amortization, including debt discounts and student loan premiums and deferred origination costs	107,969	79,484	116,781
Student loan discount accretion	(43,479)	(36,258)	(44,380)
Provision for loan losses	9,500	18,500	21,500
Derivative market value adjustment	20,310	(83,878)	27,833
Foreign currency transaction adjustment	(58,013)	35,285	19,561
Payment for interest rate swap option	(9,087)	—	—
Proceeds (payments) to terminate/amend derivative instruments, net	1,765	65,890	(6,005)
Loss (gain) on sale of loans, net	2,964	(33)	(116)
Gain from debt repurchases	(6,615)	(11,666)	(4,023)
Gain from sales of available-for-sale securities, net	(8,506)	(5,938)	(5,798)
Proceeds from sales of trading securities, net	3,128	—	—
Deferred income tax expense (benefit)	19,659	2,539	(23,829)
Non-cash compensation expense	4,699	3,329	3,020
Other	7,127	112	1,945
Decrease in accrued interest receivable	5,205	8,341	883
Decrease in accounts receivable	6,690	7,566	16
Decrease (increase) in other assets	2,372	(4,783)	2,322
Increase (decrease) in accrued interest payable	3,009	(433)	(4,864)
(Decrease) increase in other liabilities	(20,529)	4,782	16,044
Net cash provided by operating activities	357,449	387,180	299,318
Cash flows from investing activities, net of acquisitions:			
Purchases of student loans and student loan residual interests	(3,753,936)	(2,392,676)	(3,777,011)
Net proceeds from student loan repayments, claims, capitalized interest, participations, and other	3,700,005	2,852,177	3,112,744
Proceeds from sale of student loans	50,190	43,292	107,093
Purchases of available-for-sale securities	(192,998)	(219,894)	(190,250)
Proceeds from sales of available-for-sale securities	241,793	103,250	165,854
Purchases of other investments	(45,925)	(20,302)	—
Repayments of receivables and other assets	15,819	—	—
Purchases of property and equipment, net	(26,488)	(17,010)	(9,944)
(Increase) decrease in restricted cash and investments, net	(51,135)	147,743	(201,140)
Business and asset acquisitions, net of cash acquired	(46,833)	—	—
Net cash (used in) provided by investing activities	(109,508)	496,580	(792,654)
Cash flows from financing activities, net of borrowings assumed:			
Payments on bonds and notes payable	(3,632,741)	(5,153,057)	(4,444,099)
Proceeds from issuance of bonds and notes payable	3,502,316	4,312,720	5,066,950
Payments of debt issuance costs	(14,934)	(13,697)	(18,197)
Dividends paid	(18,542)	(18,569)	(66,237)
Repurchases of common stock	(15,713)	(13,136)	(22,814)
Proceeds from issuance of common stock	656	561	480
Payments received on employee stock notes receivable	—	—	1,140
Issuance of noncontrolling interest	201	5	5
Distribution to noncontrolling interest	(1,970)	(1,351)	(431)
Net cash (used in) provided by financing activities	(180,727)	(886,524)	516,797
Net increase (decrease) in cash and cash equivalents	67,214	(2,764)	23,461
Cash and cash equivalents, beginning of year	63,267	66,031	42,570
Cash and cash equivalents, end of year	\$ 130,481	63,267	66,031

Cash disbursements made for:			
Interest	\$ 210,700	190,998	234,606
Income taxes, net of refunds	\$ 155,828	154,840	114,758
Noncash activity:			
Investing activity - student loans and other assets acquired	\$ 2,571,997	1,715,260	—
Investing activity - sale of education lending subsidiary, including student loans and other assets	\$ 246,376	—	—
Investing activity - note receivable obtained in connection with sale of education lending subsidiary	\$ 20,737	—	—
Financing activity - borrowings and other liabilities transferred in sale of education lending subsidiary	\$ 225,139	—	—
Financing activity - borrowings and other liabilities assumed in acquisition of student loans	\$ 2,444,874	1,676,761	—

Supplemental disclosures of noncash operating and investing activities regarding the Company's business acquisition is contained in note 7.

See accompanying notes to consolidated financial statements.

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**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements  
(Dollars in thousands, except share amounts, unless otherwise noted)

**1. Description of Business**

Nelnet, Inc. and its subsidiaries ("Nelnet" or the "Company") provides educational services in loan servicing, payment processing, education planning, and asset management. These products and services help students and families plan, prepare, and pay for their education and make the administrative and financial processes more efficient for schools and financial organizations. In addition, the Company earns interest income on a portfolio of federally insured student loans. Substantially all revenue from external customers is earned, and all long lived assets are located, in the United States.

The Company was formed as a Nebraska corporation in 1978 to service federal student loans for two local banks. The Company built on this initial foundation as a servicer to become a leading originator, holder, and servicer of federal student loans, principally consisting of loans originated under the Federal Family Education Loan Program ("FFELP" or "FFEL Program") of the U.S. Department of Education (the "Department").

Effective July 1, 2010, the Health Care and Education Reconciliation Act of 2010 (the "Reconciliation Act of 2010") prohibits new loan originations under the FFEL Program and requires that all new federal student loan originations be made through the Federal Direct Loan Program. This law does not alter or affect the terms and conditions of existing FFELP loans. As a result of this law, the Company no longer originates new FFELP loans. However, the Company believes there will be continued opportunities to purchase FFELP loan portfolios from current FFELP loan holders looking to adjust their FFELP businesses. In addition, to reduce its reliance on interest income on student loans, the Company has significantly diversified and increased its education-related products and services.

The Company has three reportable operating segments. The Company's reportable operating segments include:

- Student Loan and Guaranty Servicing
- Tuition Payment Processing and Campus Commerce
- Asset Generation and Management

A description of each reportable operating segment is included below. In 2014, management determined that the Company's Enrollment Services business no longer met the quantitative thresholds for which separate information about an operating segment is required. Prior period segment operating results were restated to conform to the current period presentation. See note 14 for additional information on the Company's segment reporting.

***Student Loan and Guaranty Servicing***

The following are the primary products and services the Company offers as part of its Student Loan and Guaranty Servicing operating segment:

- Servicing federally-owned student loans for the Department
- Servicing FFELP loans
- Marketing, originating, and servicing private education loans
- Servicing and outsourcing services for FFELP guaranty agencies, including FFELP guaranty collection services
- Providing student loan servicing software and other information technology products and services
- Providing outsourced services including call center, processing, and marketing services

The Student Loan and Guaranty Servicing operating segment provides for the servicing of the Company's student loan portfolio and the portfolios of third parties. The loan servicing activities include loan conversion activities, application processing, borrower updates, customer service, payment processing, due diligence procedures, funds management reconciliations, and claim processing. These activities are performed internally for the Company's portfolio in addition to generating external fee revenue when performed for third-party clients.

The Company is one of four private sector companies awarded a student loan servicing contract by the Department to provide additional servicing capacity for loans owned by the Department.

## NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

This operating segment also provides servicing activities for guaranty agencies, which serve as intermediaries between the Department and FFELP lenders, and are responsible for paying the claims made on defaulted loans. The services provided by the Company include providing software and data center services, borrower and loan updates, default aversion tracking services, claim processing services, and post-default collection services.

This operating segment also provides student loan servicing software, which is used internally by the Company and licensed to third-party student loan holders and servicers. These software systems have been adapted so that they can be offered as hosted servicing software solutions usable by third parties to service various types of student loans, including Federal Direct Loan Program and FFEL Program loans.

In addition, this segment provides business process outsourcing specializing in contact center management. The contact center solutions and services include taking inbound calls, helping with outreach campaigns and sales, and interacting with customers through multi-channels.

### ***Tuition Payment Processing and Campus Commerce***

The Company's Tuition Payment Processing and Campus Commerce operating segment provides products and services to help students and families manage the payment of education costs. In addition, this operating segment provides school information system software for private and faith-based schools that help schools automate administrative processes such as admissions, scheduling, student billing, attendance, and grade book management. This segment also provides innovative education-focused technologies, services, and support solutions to help schools with the everyday challenges of collecting and processing commerce data.

In the K-12 market, the Company offers actively managed tuition payment plans and billing services, school information system software, and assistance with financial needs assessment and donor management. In the higher education market, the Company primarily offers actively managed tuition payment plans and campus commerce technologies and payment processing.

### ***Asset Generation and Management***

The Company's Asset Generation and Management operating segment includes the acquisition, management, and ownership of the Company's student loan assets, which has historically been the Company's largest product and service offering. Nearly all student loan assets included in this segment are loans originated under the FFEL Program, including the Stafford Loan Program, the PLUS Loan program, and loans that reflect the consolidation into a single loan of certain previously separate borrower obligations ("Consolidation"). The Company generates a substantial portion of its earnings from the spread, referred to as the Company's student loan spread, between the yield it receives on its student loan portfolio and the associated costs to finance such portfolio. The student loan assets are held in a series of education lending subsidiaries and associated securitization trusts designed specifically for this purpose. In addition to the student loan spread earned on its portfolio, all costs and activity associated with managing the portfolio, such as servicing of the assets and debt maintenance, are included in this segment.

### ***Corporate and Other Activities***

Other business activities and operating segments that are not reportable are combined and included in Corporate and Other Activities. Corporate and Other Activities include the following items:

- The operating results of Whitetail Rock Capital Management, LLC ("WRCM"), the Company's SEC-registered investment advisory subsidiary
- The operating results of the Enrollment Services business
- Income earned on certain investment activities
- Interest expense incurred on unsecured debt transactions
- Other product and service offerings that are not considered reportable operating segments

Corporate and Other Activities also include certain corporate activities and overhead functions related to executive management, human resources, accounting, legal, occupancy, and marketing. These costs are allocated to each operating segment based on estimated use of such activities and services.

## **2. Summary of Significant Accounting Policies and Practices**

### ***Consolidation***

The consolidated financial statements include the accounts of Nelnet, Inc. and its consolidated subsidiaries, including its education lending subsidiaries for which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's education lending subsidiaries (or Variable Interest Entities ("VIEs")) are engaged in the securitization of education finance assets. These education lending subsidiaries hold beneficial interests in eligible loans, subject to creditors with specific interests. The liabilities of the Company's education lending subsidiaries are not the direct obligations of Nelnet, Inc. or any of its other subsidiaries. Each education lending subsidiary is structured to be bankruptcy remote, meaning that it should not be consolidated in the event of bankruptcy of the parent company or any other subsidiary. The Company has determined it is the primary beneficiary of its education lending subsidiaries (VIEs). The primary beneficiary is the entity which has both: (1) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, and (2) the obligation to absorb losses or receive benefits of the entity that could potentially be significant to the VIE. The Company is generally the administrator and master servicer of the securitized assets held in its education lending subsidiaries and owns the residual interest of the securitization trusts. As a result, for accounting purposes, the transfers of student loans to the eligible lender trusts do not qualify as sales. Accordingly, all the financial activities and related assets and liabilities, including debt, of the securitizations are reflected in the Company's consolidated financial statements and are summarized as supplemental information on the balance sheet.

### ***Noncontrolling Interest***

Noncontrolling interest reflects the proportionate share of membership interest (equity) and net income attributable to the holders of minority membership interests in WRCM.

### ***Use of Estimates***

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities, reported amounts of revenues and expenses, and other disclosures. Actual results may differ from those estimates.

### ***Student Loans Receivable***

Student loans consist of federally insured student loans and private education loans. If the Company has the ability and intent to hold loans for the foreseeable future, such loans are held for investment and carried at amortized cost. Amortized cost includes the unamortized premium or discount and capitalized origination costs and fees, all of which are amortized to interest income. Loans which are held-for-investment also have an allowance for loan loss as needed. Any loans the Company has the ability and intent to sell are classified as held for sale and are carried at the lower of cost or fair value. Loans which are held for sale do not have the associated premium or discount and origination costs and fees amortized into interest income and there is also no related allowance for loan losses. There were no loans classified as held for sale as of December 31, 2014 and 2013.

Federally insured loans were originated under the FFEL Program by certain eligible lenders as defined by the Higher Education Act of 1965, as amended (the "Higher Education Act"). These loans, including related accrued interest, are guaranteed at their maximum level permitted under the Higher Education Act by an authorized guaranty agency, which has a contract of reinsurance with the Department. The terms of the loans, which vary on an individual basis, generally provide for repayment in monthly installments of principal and interest. Generally, Stafford and PLUS loans have repayment periods between five and ten years. Consolidation loans have repayment periods of twelve to thirty years. FFELP loans do not require repayment while the borrower is in-school, and during the grace period immediately upon leaving school. The borrower may also be granted a deferment or forbearance for a period of time based on need, during which time the borrower is not considered to be in repayment. Interest continues to accrue on loans in the in-school, deferment, and forbearance period. Interest rates on loans may be fixed or variable, dependent upon the type of loan, terms of the loan agreements, and date of origination.

## NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

Substantially all FFELP loan principal and related accrued interest is guaranteed as provided by the Higher Education Act. These guarantees are subject to the performance of certain loan servicing due diligence procedures stipulated by applicable Department regulations. If these due diligence requirements are not met, affected student loans may not be covered by the guarantees in the event of borrower default. Such student loans are subject to “cure” procedures and reinstatement of the guarantee under certain circumstances.

Student loans receivable also includes private education loans. Private education loans are loans to students or their families that are non-federal loans and loans not insured or guaranteed under the FFELP. These loans are used primarily to bridge the gap between the cost of higher education and the amount funded through financial aid, federal loans, or borrowers' resources. The terms of the private education loans, which vary on an individual basis, generally provide for repayment in monthly installments of principal and interest over a period of up to 30 years. The private education loans are not covered by a guarantee or collateral in the event of borrower default.

### *Allowance for Loan Losses*

The allowance for loan losses represents management's estimate of probable losses on student loans. The provision for loan losses reflects the activity for the applicable period and provides an allowance at a level that the Company's management believes is appropriate to cover probable losses inherent in the loan portfolio. The Company evaluates the adequacy of the allowance for loan losses on its federally insured loan portfolio separately from its private education loan portfolio. These evaluation processes are subject to numerous judgments and uncertainties.

The allowance for the federally insured loan portfolio is based on periodic evaluations of the Company's loan portfolios considering loans in repayment versus those in a nonpaying status, delinquency status, trends in defaults in the portfolio based on Company and industry data, past experience, trends in student loan claims rejected for payment by guarantors, changes to federal student loan programs, current economic conditions, and other relevant factors. The federal government guarantees 97 percent of the principal of and the interest on federally insured student loans disbursed on and after July 1, 2006 (and 98 percent for those loans disbursed on and after October 1, 1993 and prior to July 1, 2006), which limits the Company's loss exposure on the outstanding balance of the Company's federally insured portfolio. Student loans disbursed prior to October 1, 1993 are fully insured.

In determining the appropriate allowance for loan losses on the private education loans, the Company considers several factors, including: loans in repayment versus those in a nonpaying status, delinquency status, type of program, trends in defaults in the portfolio based on Company and industry data, past experience, current economic conditions, and other relevant factors. The Company places a private education loan on nonaccrual status when the collection of principal and interest is 30 days past due, and charges off the loan when the collection of principal and interest is 120 days past due. Collections, if any, are reflected as a recovery through the allowance for loan losses.

Management has determined that each of the federally insured loan portfolio and the private education loan portfolio meets the definition of a portfolio segment, which is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. Accordingly, the portfolio segment disclosures are presented on this basis in note 3 for each of these portfolios. The Company does not disaggregate its portfolio segment student loan portfolios into classes of financing receivables. In addition, as of December 31, 2014 and 2013, the Company did not have any impaired loans as defined in the Receivables Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification.

For loans purchased where there is evidence of credit deterioration since the origination of the loan, the Company records a credit discount, separate from the allowance for loan losses, which is non-accretable to interest income. Remaining discounts and premiums for purchased loans are recognized in interest income over the remaining estimated lives of the loans. The Company continues to evaluate credit losses associated with purchased loans based on current information and changes in expectations to determine the need for any additional allowance for loan losses.

### *Cash and Cash Equivalents and Statement of Cash Flows*

For purposes of the consolidated statements of cash flows, the Company considers all investments with maturities when purchased of three months or less to be cash equivalents.

Accrued interest on loans purchased and sold is included in cash flows from operating activities in the respective period. Net purchased accrued interest was \$55.0 million, \$29.0 million, and \$68.0 million in 2014, 2013, and 2012, respectively.

### ***Investments***

The Company's available-for-sale investment portfolio consists of student loan asset-backed securities and equity and debt securities. These securities are carried at fair value, with the temporary changes in fair value, net of taxes, carried as a separate component of shareholders' equity. The amortized cost of debt securities in this category (including the student loan asset-backed securities) is adjusted for amortization of premiums and accretion of discounts, which are amortized using the effective interest rate method. Other-than-temporary impairment is evaluated by considering several factors, including the length of time and extent to which the fair value has been less than the amortized cost basis, the financial condition and near-term prospects of the issuer of the security (considering factors such as adverse conditions specific to the security and ratings agency actions), and the intent and ability of the Company to retain the investment to allow for any anticipated recovery in fair value. The entire fair value loss on a security that has experienced an other-than-temporary impairment is recorded in earnings if the Company intends to sell the security or if it is more likely than not that the Company will be required to sell the security before the expected recovery of the loss. However, if the impairment is other-than-temporary, and either of those two conditions does not exist, the portion of the impairment related to credit losses is recorded in earnings and the impairment related to other factors is recorded in other comprehensive income.

Securities classified as trading are accounted for at fair value, with unrealized gains and losses included in "other income" in the consolidated statements of income.

Securities that the Company has the intent and ability to hold to maturity are classified as held-to-maturity and are accounted for at amortized cost unless the security is determined to have an other-than-temporary impairment. In that case, it is accounted for in the same manner as described above for available-for-sale investments.

When an investment is sold, the cost basis is determined through specific identification of the security sold.

### ***Restricted Cash and Investments***

Restricted cash primarily includes amounts for student loan securitizations and other secured borrowings. This cash must be used to make payments related to trust obligations. Amounts on deposit in these accounts are primarily the result of timing differences between when principal and interest is collected on the student loans held as trust assets and when principal and interest is paid on the trust's asset-backed debt securities. Restricted cash also includes collateral deposits with derivative counterparties.

Cash balances that the Company's indentured trusts deposit in guaranteed investment contracts that are held for the related asset-backed note holders are classified as restricted investments. The Company has classified these investments as held-to-maturity and accounts for them at amortized cost, which approximates fair value.

### ***Restricted Cash - Due to Customers***

As a servicer of student loans, the Company collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. In addition, as part of the Company's Tuition Payment Processing and Campus Commerce operating segment, the Company collects tuition payments and subsequently remits these payments to the appropriate schools. Cash collected for customers and the related liability are included in the accompanying consolidated balance sheets.

### ***Accounts Receivable***

Accounts receivable are presented at their net realizable values, which include allowances for doubtful accounts. Allowance estimates are based upon individual customer experience, as well as the age of receivables and likelihood of collection.

### ***Business Combinations***

The Company uses the acquisition method in accounting for acquired businesses. Under the acquisition method, the financial statements reflect the operations of an acquired business starting from the completion of the acquisition. The assets acquired and liabilities assumed are recorded at their respective estimated fair values at the date of acquisition. Any excess of the purchase price over the estimated fair values of the identifiable net assets acquired is recorded as goodwill. All contingent consideration is measured at fair value on the acquisition date and included in the consideration transferred in the acquisition. Contingent

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
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consideration classified as a liability is remeasured to fair value at each reporting date until the contingency is resolved, and changes in fair value are recognized in earnings.

***Goodwill***

The Company reviews goodwill for impairment annually (in the fourth quarter) and whenever triggering events or changes in circumstances indicate its carrying value may not be recoverable. Goodwill is tested for impairment using a fair value approach at the reporting unit level. A reporting unit is the operating segment, or a business one level below that operating segment if discrete financial information is prepared and regularly reviewed by segment management. However, components are aggregated as a single reporting unit if they have similar economic characteristics.

The Company tests goodwill for impairment in accordance with applicable accounting guidance. The guidance provides an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not (more than 50%) that the estimated fair value of a reporting unit is less than its carrying amount. If an entity elects to perform a qualitative assessment and determines that an impairment is more likely than not, the entity is then required to perform a two-step quantitative impairment test (described below), otherwise no further analysis is required. An entity also may elect not to perform the qualitative assessment and, instead, proceed directly to the two-step quantitative impairment test.

If the Company elects to not perform a qualitative assessment or if the Company determines it is more likely than not that the fair value of a reporting unit is less than the carrying amount, then the Company performs a two-step impairment test on goodwill. In the first step, the Company compares the fair value of each reporting unit to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is considered not impaired and the Company is not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then the Company would record an impairment loss equal to the difference.

Determining the fair value of a reporting unit involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, and determination of appropriate market comparables. Actual future results may differ from those estimates.

See note 9 for information regarding the Company's annual goodwill impairment review.

***Intangible Assets***

Intangible assets with finite lives are amortized over their estimated lives. Such assets are amortized using a method of amortization that reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, the Company uses a straight-line amortization method.

The Company evaluates the estimated remaining useful lives of purchased intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization.

***Property and Equipment***

Property and equipment are carried at cost, net of accumulated depreciation. Maintenance and repairs are charged to expense as incurred, and major improvements, including leasehold improvements, are capitalized. Gains and losses from the sale of property and equipment are included in determining net income. The Company uses accelerated and straight-line methods for recording depreciation and amortization. Accelerated methods are used for certain equipment and software when this method is believed to provide a better matching of income and expenses. Leasehold improvements are amortized over the lesser of their useful life or the related estimated lease period.



### ***Impairment of Long-Lived Assets***

The Company reviews its long-lived assets, such as property and equipment and purchased intangibles subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. The Company uses estimates to determine the fair value of long-lived assets. Such estimates are generally based on estimated future cash flows or cost savings associated with particular assets and are discounted to present value using an appropriate discount rate. The estimates of future cash flows associated with assets are generally prepared using a cost savings method, a lost income method, or an excess return method, as appropriate. In utilizing such methods, management must make certain assumptions about the amount and timing of estimated future cash flows and other economic benefits from the assets, the remaining economic useful life of the assets, and general economic factors concerning the selection of an appropriate discount rate. The Company may also use replacement cost or market comparison approaches to estimating fair value if such methods are determined to be more appropriate.

Assumptions and estimates about future values and remaining useful lives of the Company's intangible and other long-lived assets are complex and subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Company's business strategy and internal forecasts. Although the Company believes the historical assumptions and estimates used are reasonable and appropriate, different assumptions and estimates could materially impact the reported financial results.

### ***Other Assets***

Other assets are recorded at cost or amortized cost and consist primarily of debt issuance costs, certain investments, and other miscellaneous assets. Debt issuance costs are amortized using the effective interest method.

### ***Fair Value Measurements***

The Company uses estimates of fair value in applying various accounting standards for its financial statements.

Fair value is defined as the price to sell an asset or transfer a liability in an orderly transaction between willing and able market participants. In general, the Company's policy in estimating fair values is to first look at observable market prices for identical assets and liabilities in active markets, where available. When these are not available, other inputs are used to model fair value, such as prices of similar instruments, yield curves, volatilities, prepayment speeds, default rates, and credit spreads, relying first on observable data from active markets. Depending on current market conditions, additional adjustments to fair value may be based on factors such as liquidity, credit, and bid/offer spreads. In some cases fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Transaction costs are not included in the determination of fair value. When possible, the Company seeks to validate the model's output to market transactions. Depending on the availability of observable inputs and prices, different valuation models could produce materially different fair value estimates. The values presented may not represent future fair values and may not be realizable. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the estimates of current or future values.

The Company categorizes its fair value estimates based on a hierarchical framework associated with three levels of price transparency utilized in measuring assets and liabilities at fair value. Classification is based on the lowest level of input that is significant to the fair value of the instrument. The three levels include:

- Level 1: Quoted prices for *identical* instruments in active markets. The types of financial instruments included in Level 1 are highly liquid instruments with quoted prices.
- Level 2: Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose primary value drivers are observable.

## NELNET, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

- Level 3: Instruments whose primary value drivers are *unobservable*. Inputs are developed based on the best information available; however, significant judgment is required by management in developing the inputs.

The Company's accounting policy is to recognize transfers between levels of the fair value hierarchy at the end of the reporting period.

#### **Revenue Recognition**

*Loan interest income* - Loan interest is paid by the Department or the borrower, depending on the status of the loan at the time of the accrual. In addition, the Department makes quarterly interest subsidy payments on certain qualified FFELP loans until the student is required under the provisions of the Higher Education Act to begin repayment. Borrower repayment of FFELP loans normally begins within six months after completion of the borrower's course of study, leaving school, or ceasing to carry at least one-half the normal full-time academic load, as determined by the educational institution. Borrower repayment of PLUS and Consolidation loans normally begins within 60 days from the date of loan disbursement. Borrower repayment of private education loans typically begins six months following the borrower's graduation from a qualified institution, and the interest is either paid by the borrower or capitalized annually or at repayment.

The Department provides a special allowance to lenders participating in the FFEL Program. The special allowance is accrued based upon the fiscal quarter average rate of 13-week Treasury Bill auctions (for loans originated prior to January 1, 2000) or the fiscal quarter average rate of daily one-month LIBOR rates (for loans originated on and after January 1, 2000) relative to the yield of the student loan.

The Company recognizes student loan income as earned, net of amortization of loan premiums and deferred origination costs and the accretion of loan discounts. Loan income is recognized based upon the expected yield of the loan after giving effect to interest rate reductions resulting from borrower utilization of incentives such as timely payments ("borrower benefits") and other yield adjustments. Loan premiums or discounts, deferred origination costs, and borrower benefits are amortized/accreted over the estimated life of the loan, which includes an estimate of prepayment rates. The Company periodically evaluates the assumptions used to estimate the life of the loans and prepayment rates.

The Company also pays the Department an annual 105 basis point rebate fee on Consolidation loans. These rebate fees are netted against loan interest income.

*Student loan and guaranty servicing revenue* – Student loan and guaranty servicing revenue consists of the following items:

- *Loan and guaranty servicing fees* – Loan servicing fees are determined according to individual agreements with customers and are calculated based on the dollar value of loans, number of loans, or number of borrowers serviced for each customer. Guaranty servicing fees are generally calculated based on the number of loans serviced, volume of loans serviced, or amounts collected. Revenue is recognized over the period in which services are provided to customers, and when ultimate collection is assured.
- *Guaranty collections revenue* – Guaranty collections revenue is earned when collected. Collection costs paid to third parties associated with this revenue is expensed upon successful collection.
- *Software services revenue* – Software services revenue is determined from individual agreements with customers and includes license and maintenance fees associated with student loan software products. Computer and software consulting and remote hosting revenues are recognized over the period in which services are provided to customers.

*Tuition payment processing, school information, and campus commerce revenue* - Tuition payment processing, school information, and campus commerce revenue includes actively managed tuition payment solutions, remote hosted school information systems software, and online payment processing. Fees for these services are recognized over the period in which services are provided to customers. Cash received in advance of the delivery of services is included in deferred revenue.



## NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

*Enrollment Services Revenue* – Enrollment services revenue primarily consists of the following items:

- *Inquiry Generation and Management* - This revenue is derived primarily from fees which are earned through the delivery of qualified inquiries or clicks. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured. Delivery is deemed to have occurred at the time a qualified inquiry or click is delivered to the customer, provided that no significant obligations remain. From time to time, the Company may agree to credit certain inquiries or clicks if they fail to meet the contractual or other guidelines of a particular client. The Company has established a sales reserve based on historical experience. To date, such credits have been immaterial and within management's expectations.

For a portion of this revenue, the Company has agreements with providers of online media or traffic ("inquiry generation vendors") used in the generation of inquiries or clicks. The Company receives a fee from its customers and pays a fee to the inquiry generation vendors either on a cost per inquiry, cost per click, or cost per number of impressions basis. The Company is the primary obligor in the transaction. As a result, the fees paid by the Company's customers are recognized as revenue and the fees paid to its inquiry generation vendors are included in "cost to provide enrollment services" in the Company's consolidated statements of income.

- *Content Solutions* - Several content solutions services, including services to connect students to colleges and universities, are sold based on subscriptions. Revenue from sales of subscription services is recognized ratably over the term of the contract as earned. Subscription revenue received or receivable in advance of the delivery of services is included in deferred revenue. Revenue from the sale of print products is generally earned and recognized, net of estimated returns, upon shipment or delivery. All other revenue is recognized over the period in which services are provided to customers.

*Other income* - Other income includes realized and unrealized gains and losses on investments and borrower late fee income, which is earned by the education lending subsidiaries and is recognized when payments are collected from the borrower. Other income also includes investment advisory income. The Company provides investment advisory services through an SEC-registered investment advisor subsidiary under various arrangements and earns annual fees on the outstanding balance of investments and certain performance measures, which are recognized monthly as earned.

### *Interest Expense*

Interest expense is based upon contractual interest rates, adjusted for the amortization of debt issuance costs and the accretion of discounts. The amortization of debt issuance costs and accretion of discounts are recognized using the effective interest method.

### *Transfer of Financial Assets and Extinguishments of Liabilities*

The Company accounts for loan sales and debt repurchases in accordance with applicable accounting guidance. If a transfer of loans qualifies as a sale, the Company derecognizes the loan and recognizes a gain or loss as the difference between the carrying basis of the loan sold and the consideration received. The Company from time to time repurchases its outstanding debt and records a gain or loss on the early extinguishment of debt based upon the difference between the carrying amount of the debt and the amount paid to the third party. The Company recognizes the results of a transfer of loans and the extinguishment of debt based upon the settlement date of the transaction.

### *Derivative Accounting*

The Company records derivative instruments on the consolidated balance sheets as either an asset or liability measured at its fair value. The Company determines the fair value for its derivative instruments using either (i) pricing models that consider current market conditions and the contractual terms of the derivative instrument or (ii) counterparty valuations. The Company does not offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from derivative instruments that are recognized at fair value and executed with the same counterparty under a master netting arrangement. The factors that impact the fair value of the Company's derivatives include interest rates, time value, forward interest rate curve, and volatility factors, as well as foreign exchange rates. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized, and the use of different pricing models or assumptions could produce different financial results. Management has structured all of the Company's derivative transactions with the intent that each is economically effective; however, the Company's derivative instruments do not qualify for hedge accounting. As a result, the change in fair value of derivative instruments is reported

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## NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

in current period earnings. Changes or shifts in the forward yield curve and fluctuations in currency rates can significantly impact the valuation of the Company's derivatives, and therefore impact the financial position and results of operations of the Company. Any proceeds received or payments made by the Company to terminate a derivative in advance of its expiration date, or to amend the terms of an existing derivative, are included in the Company's consolidated statements of income and are accounted for as a change in fair value of such derivative. The changes in fair value of derivative instruments, as well as the settlement payments made on such derivatives, are included in "derivative market value and foreign currency adjustments and derivative settlements, net" on the consolidated statements of income.

### ***Foreign Currency***

During 2006, the Company issued Euro-denominated bonds, which are included in "bonds and notes payable" on the consolidated balance sheets. Transaction gains and losses resulting from exchange rate changes when re-measuring these bonds to U.S. dollars at the balance sheet date are included in "derivative market value and foreign currency adjustments and derivative settlements, net" on the consolidated statements of income.

### ***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Income tax expense includes deferred tax expense, which represents the net change in the deferred tax asset or liability balance during the year, plus any change made in the valuation allowance, and current tax expense, which represents the amount of tax currently payable to or receivable from a tax authority plus amounts for expected tax deficiencies (including both tax and interest).

### ***Compensation Expense for Stock Based Awards***

The Company has a restricted stock plan that is intended to provide incentives to attract, retain, and motivate employees in order to achieve long term growth and profitability objectives. The restricted stock plan provides for the grant to eligible employees of awards of restricted shares of Class A common stock. The fair value of restricted stock awards is determined on the grant date based on the Company's stock price and is amortized to compensation cost over the related vesting periods, which range up to ten years. For those awards with only service conditions that have graded vesting schedules, the Company recognizes compensation expense on a straight-line basis over the requisite service period for each separately vesting portion of the award, as if the award was, in substance, multiple awards.

### ***Stock Repurchases***

In accordance with the corporate laws of the state in which the Company is incorporated, all shares repurchased by the Company are legally retired upon acquisition by the Company.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

**3. Student Loans Receivable and Allowance for Loan Losses**

Student loans receivable consisted of the following:

	<b>As of December 31,</b>	
	<b>2014</b>	<b>2013</b>
Federally insured loans		
Stafford and other	\$ 6,030,825	6,686,626
Consolidation	22,165,605	19,363,577
Total	28,196,430	26,050,203
Private education loans	27,478	71,103
	28,223,908	26,121,306
Loan discount, net of unamortized loan premiums and deferred origination costs (a)	(169,813)	(158,595)
Allowance for loan losses – federally insured loans	(39,170)	(43,440)
Allowance for loan losses – private education loans	(9,730)	(11,682)
	<u>\$ 28,005,195</u>	<u>25,907,589</u>

(a) At December 31, 2014 and 2013, "loan discount, net of unamortized loan premiums and deferred origination costs" included \$28.8 million and \$20.2 million, respectively, of non-accretable discount associated with purchased loans of \$8.5 billion and \$4.4 billion, respectively.

***Student Loan Residual Interests***

On October 31, 2013, the Company acquired the ownership interest in GCO Education Loan Funding Trust-II (the "GCO Trust-II") giving the Company rights to the residual interest in \$1.6 billion of securitized federally insured consolidation loans. GCO Trust-II includes loans funded to term with \$1.6 billion (par value) of notes payable that carry interest rates on a spread to LIBOR or are set and periodically reset via a "dutch auction."

On April 25, 2014, the Company acquired the ownership interest in three FFELP student loan securitization trusts (the "2014 Trusts") giving the Company rights to the residual interest in a total of \$2.6 billion of securitized federally insured loans and related assets. The 2014 Trusts include loans funded to term with \$2.6 billion (par value) of notes payable that carry interest rates on a spread to LIBOR or are set and periodically reset via a "dutch auction."

The Company has consolidated these trusts on its consolidated balance sheet because management has determined the Company is the primary beneficiary of the trusts. Upon acquisition of the GCO Trust II and the 2014 Trusts, the Company recorded all assets and liabilities of the trusts at fair value, resulting in the recognition of a student loan fair value discount of \$52.9 million and \$68.7 million, respectively, and a bonds and notes payable fair value discount of \$91.8 million and \$163.7 million, respectively. These discounts will be accreted using the effective interest method over the lives of the underlying assets and liabilities. All other assets acquired and liabilities assumed (restricted cash, accrued interest receivable/payable, and other assets/liabilities) were recorded at cost, which approximates fair value.

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

**Activity in the Allowance for Loan Losses**

The provision for loan losses represents the periodic expense of maintaining an allowance sufficient to absorb losses, net of recoveries, inherent in the portfolio of student loans. Activity in the allowance for loan losses is shown below.

	Year ended December 31,		
	2014	2013	2012
Balance at beginning of period	\$ 55,122	51,902	48,482
Provision for loan losses:			
Federally insured loans	11,000	20,000	22,000
Private education loans	(1,500)	(1,500)	(500)
Total provision for loan losses	9,500	18,500	21,500
Charge-offs:			
Federally insured loans	(15,260)	(15,588)	(21,217)
Private education loans	(2,332)	(3,683)	(3,508)
Total charge-offs	(17,592)	(19,271)	(24,725)
Recoveries - private education loans	1,315	1,577	1,419
Purchase (sale) of federally insured loans, net	(10)	(1,093)	2,133
Sale of private education loans	(1,620)	—	—
Transfer from repurchase obligation related to private education loans repurchased, net	2,185	3,507	3,093
Balance at end of period	\$ 48,900	55,122	51,902
Allocation of the allowance for loan losses:			
Federally insured loans	\$ 39,170	43,440	40,120
Private education loans	9,730	11,682	11,782
Total allowance for loan losses	\$ 48,900	55,122	51,902

**Repurchase Obligation**

The Company has sold various portfolios of private education loans to third-parties. Per the terms of the servicing agreements, the Company's servicing operations are obligated to repurchase loans subject to the sale agreements in the event such loans become 60 or 90 days delinquent. As of December 31, 2014, the balance of loans subject to these repurchase obligations was \$155.3 million. The Company's estimate related to its obligation to repurchase these loans is included in "other liabilities" in the Company's consolidated balance sheets. The activity related to this accrual is detailed below.

	Year ended December 31,		
	2014	2013	2012
Beginning balance	\$ 16,143	16,130	19,223
Repurchase obligation transferred to the allowance for loan losses related to loans repurchased, net	(2,185)	(3,507)	(3,093)
Repurchase obligation associated with loans sold	2,097	3,520	—
Current period income (a)	(4,235)	—	—
Ending balance	\$ 11,820	16,143	16,130

- (a) During 2014, the Company recognized income related to the modification of certain servicing agreements in which the repurchase obligation was reduced. This income is included in "other income" on the consolidated statements of income.

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

***Student Loan Status and Delinquencies***

Delinquencies have the potential to adversely impact the Company's earnings through increased servicing and collection costs and account charge-offs. The percent of private education loans that were delinquent 31 days or greater as of December 31, 2014, 2013, and 2012 was 29.8 percent, 12.7 percent, and 28.6 percent, respectively. The table below shows the Company's federally insured student loan delinquency amounts.

	As of December 31,							
	2014		2013		2012			
<b>Federally insured loans:</b>								
Loans in-school/grace/deferment (a)	\$	2,805,228		\$	2,872,505	\$	3,099,637	
Loans in forbearance (b)		3,288,412			3,370,025		3,322,301	
Loans in repayment status:								
Loans current		18,460,279	83.5%		16,337,922	82.4%	15,253,249	82.2%
Loans delinquent 31-60 days (c)		1,043,119	4.8		967,318	4.9	766,146	4.1
Loans delinquent 61-90 days (c)		588,777	2.7		550,333	2.9	410,576	2.2
Loans delinquent 91-120 days (c)		404,905	1.8		390,791	2.0	433,659	2.3
Loans delinquent 121-270 days (c)		1,204,405	5.4		1,117,936	5.6	1,236,943	6.7
Loans delinquent 271 days or greater (c)(d)		401,305	1.8		443,373	2.2	447,335	2.5
Total loans in repayment		22,102,790	100.0%		19,807,673	100.0%	18,547,908	100.0%
Total federally insured loans	\$	28,196,430		\$	26,050,203		\$	24,969,846

- (a) Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are not yet required to make payments on the loans, *e.g.*, residency periods for medical students or a grace period for bar exam preparation for law students.
- (b) Loans for borrowers who have temporarily ceased making full payments due to hardship or other factors, according to a schedule approved by the servicer consistent with the established loan program servicing procedures and policies.
- (c) The period of delinquency is based on the number of days scheduled payments are contractually past due and relate to repayment loans, that is, receivables not charged off, and not in school, grace, deferment, or forbearance.
- (d) A portion of loans included in loans delinquent 271 days or greater includes loans in claim status, which are loans that have gone into default and have been submitted to the guaranty agency.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

**4. Bonds and Notes Payable**

The following tables summarize the Company's outstanding debt obligations by type of instrument:

	As of December 31, 2014		
	Carrying amount	Interest rate range	Final maturity
Variable-rate bonds and notes issued in asset-backed securitizations:			
Bonds and notes based on indices	\$ 25,713,431	0.19% - 6.90%	5/25/18 - 8/26/52
Bonds and notes based on auction	1,311,669	0.47% - 2.17%	3/22/32 - 11/26/46
Total variable-rate bonds and notes	27,025,100		
FFELP warehouse facilities	1,241,665	0.16% - 0.26%	1/17/16 - 6/11/17
Unsecured line of credit	—	—	6/30/19
Unsecured debt - Junior Subordinated Hybrid Securities	71,688	3.63%	9/15/61
Other borrowings	81,969	1.67% - 5.10%	11/11/15 - 12/31/18
	28,420,422		
Discount on bonds and notes payable	(393,072)		
<b>Total</b>	<b>\$ 28,027,350</b>		

	As of December 31, 2013		
	Carrying amount	Interest rate range	Final maturity
Variable-rate bonds and notes issued in asset-backed securitizations:			
Bonds and notes based on indices	\$ 23,479,893	0.25% - 6.90%	5/25/18 - 8/26/52
Bonds and notes based on auction or remarketing	1,134,250	0.07% - 2.17%	5/1/28 - 11/26/46
Total variable-rate bonds and notes	24,614,143		
FFELP warehouse facilities	1,396,344	0.17% - 0.25%	1/17/16 - 6/12/16
Unsecured line of credit	45,000	1.67%	3/28/18
Unsecured debt - Junior Subordinated Hybrid Securities	96,457	3.62%	9/15/61
Other borrowings	61,401	1.67% - 5.10%	4/11/14 - 11/11/15
	26,213,345		
Discount on bonds and notes payable	(258,056)		
<b>Total</b>	<b>\$ 25,955,289</b>		

***Secured Financing Transactions***

The Company has historically relied upon secured financing vehicles as its most significant source of funding for student loans. The net cash flow the Company receives from the securitized student loans generally represents the excess amounts, if any, generated by the underlying student loans over the amounts required to be paid to the bondholders, after deducting servicing fees and any other expenses relating to the securitizations. The Company's rights to cash flow from securitized student loans are subordinate to bondholder interests, and the securitized student loans may fail to generate any cash flow beyond what is due to bondholders. The Company's secured financing vehicles during the periods presented include loan warehouse facilities and asset-backed securitizations.

The majority of the bonds and notes payable are primarily secured by the student loans receivable, related accrued interest, and by the amounts on deposit in the accounts established under the respective bond resolutions or financing agreements.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

**FFELP warehouse facilities**

The Company funds a portion of its FFELP loan acquisitions using its FFELP warehouse facilities. Student loan warehousing allows the Company to buy and manage student loans prior to transferring them into more permanent financing arrangements.

As of December 31, 2014, the Company had three FFELP warehouse facilities as summarized below.

	<b>NHELP-III (a)</b>	<b>NHELP-II (b)</b>	<b>NFSLW-I (c)</b>	<b>Total</b>
Maximum financing amount	\$ 750,000	500,000	500,000	1,750,000
Amount outstanding	692,613	100,637	448,415	1,241,665
Amount available	\$ 57,387	399,363	51,585	508,335
Expiration of liquidity provisions	February 5, 2015	January 15, 2015	June 11, 2015	
Final maturity date	January 17, 2016	January 15, 2017	June 11, 2017	
Maximum advance rates	92.2 - 95.0%	84.5 - 94.5%	92.0 - 98.0%	
Minimum advance rates	92.2 - 95.0%	84.5 - 94.5%	84.0 - 90.0%	
Advanced as equity support	\$ 41,578	9,924	21,931	73,433

- (a) On February 4, 2015, the Company amended the agreement for this warehouse facility to change the expiration date for the liquidity provisions to May 5, 2015.
- (b) On January 9, 2015, the Company amended the agreement for this warehouse facility to change the expiration date for the liquidity provisions to December 17, 2015, and to change the maturity date to December 17, 2017.
- (c) On January 27, 2015, the Company amended the agreement for this warehouse facility to temporarily increase the maximum financing amount to \$1.2 billion. The maximum financing amount is scheduled to decrease \$200.0 million and \$250.0 million on April 30, 2015 and May 31, 2015, respectively.

Each FFELP warehouse facility is supported by 364-day liquidity provisions, which are subject to the respective expiration date shown in the previous table. In the event the Company is unable to renew the liquidity provisions by such date, the facility would become a term facility at a stepped-up cost, with no additional student loans being eligible for financing, and the Company would be required to refinance the existing loans in the facility by the facility's final maturity date. The NFSLW-I warehouse facility provides for formula-based advance rates, depending on FFELP loan type, up to a maximum of the principal and interest of loans financed as shown in the table above. The advance rates for collateral may increase or decrease based on market conditions, but they are subject to minimums as disclosed above. The NHELP-III and NHELP-II warehouse facilities have static advance rates that require initial equity for loan funding, but do not require increased equity based on market movements.

The FFELP warehouse facilities contain financial covenants relating to levels of the Company's consolidated net worth, ratio of recourse indebtedness to adjusted EBITDA, and unencumbered cash. Any noncompliance with these covenants could result in a requirement for the immediate repayment of any outstanding borrowings under the facilities.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
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Asset-backed securitizations

The following tables summarize the asset-backed securitization transactions completed in 2014 and 2013 .

Securitizations completed during the year ended December 31, 2014												
	2014-1	2014-2				2014-3	2014-4			2014-5	2014-6 (a)	Total
		Class A-1 notes	Class A-2 notes	Class A-3 notes	2014-2 total		Class A-1 notes	Class A-2 notes	2014-4 total			
Date securities issued	2/6/14	3/12/14	3/12/14	3/12/14	3/12/14	4/30/14	5/23/14	5/23/14	5/23/14	6/18/14	7/31/14	
Total original principal amount	\$ 458,500				509,000	719,800			384,500	603,000	565,000	\$ 3,239,800
Class A senior notes:												
Total original principal amount	\$ 445,000	191,000	222,000	84,000	497,000	700,700	267,500	107,500	375,000	587,000	565,000	3,169,700
Bond discount	—	—	—	(535)	(535)	—	—	—	—	—	(3,124)	(3,659)
Issue price	\$ 445,000	191,000	222,000	83,465	496,465	700,700	267,500	107,500	375,000	587,000	561,876	3,166,041
Cost of funds (1-month LIBOR plus:)	0.57%	0.28%	0.60%	0.85%		0.58%	0.54%	0.95%		0.55%	0.65%	
Final maturity date	9/25/41	6/25/21	3/25/30	7/27/37		6/25/41	11/27/34	11/25/43		7/25/41	11/25/47	
Class B subordinated notes:												
Total original principal amount	\$ 13,500				12,000	19,100			9,500	16,000		70,100
Bond discount	(1,132)				(1,046)	(1,467)			(1,138)	(1,232)		(6,015)
Issue price	\$ 12,368				10,954	17,633			8,362	14,768		64,085
Cost of funds (1-month LIBOR plus:)	1.50%				1.50%	1.50%			1.50%	1.50%		
Final maturity date	10/25/47				6/25/41	10/25/50			9/25/51	5/25/49		

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**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

Securitizations completed during the year ended December 31, 2013						
	2013-1	2013-2 (a)	2013-3	2013-4	2013-5 (a)	Total
Date securities issued	1/31/13	2/28/13	4/30/13	6/21/13	9/30/13	
Total original principal amount	\$ 437,500	1,122,000	765,000	453,000	399,000	\$ 3,176,500
Class A senior notes:						
Total original principal amount	\$ 428,000	1,122,000	745,000	440,000	399,000	3,134,000
Bond discount	—	(3,325)	—	(1,690)	(4,881)	(9,896)
Issue price	\$ 428,000	1,118,675	745,000	438,310	394,119	3,124,104
Cost of funds (1-month LIBOR plus:)	0.60%	0.50%	0.50%	0.50%	0.63%	
Final maturity date	6/25/41	7/25/40	2/25/37	12/26/42	1/25/37	
Class B subordinated notes:						
Total original principal amount	\$ 9,500		20,000	13,000		42,500
Bond discount	(1,525)		(1,762)	(1,804)		(5,091)
Issue price	\$ 7,975		18,238	11,196		37,409
Cost of funds (1-month LIBOR plus:)	1.50%		1.50%	1.50%		
Final maturity date	3/25/48		7/25/47	1/25/47		

- (a) Total original principal amount excludes the Class B subordinated tranches for the 2014-6, 2013-2, and 2013-5 transactions totaling \$8.3 million, \$34.0 million, and \$9.0 million, respectively, that were retained at issuance. As of December 31, 2014, the Company has a total of \$36.0 million (par value) of its own Class B subordinated notes remaining from prior completed asset-backed securitizations that are not included in the Company's consolidated balance sheet. If the Company sells these notes to third parties, the Company would obtain cash proceeds equal to the market value of the notes on the date of such sale. Upon sale, these notes would be shown as "bonds and notes payable" in the Company's consolidated balance sheet. The Company believes the market value of such notes is currently less than par value. Any excess of the par value over the market value on the date of sale would be recognized by the Company as interest expense over the life of the bonds.

#### *Auction Rate Securities*

The interest rates on certain of the Company's asset-backed securities are set and periodically reset via a "dutch auction" ("Auction Rate Securities"). As of December 31, 2014, the Company is currently sponsor on \$1.3 billion of Auction Rate Securities.

Since February 2008, problems in the auction rate securities market as a whole have led to failures of the auctions pursuant to which the Company's Auction Rate Securities' interest rates are set. As a result, the Auction Rate Securities generally pay interest to the holder at a maximum rate as defined by the indenture. While these rates will vary, they will generally be based on a spread to LIBOR or Treasury Securities, or the Net Loan Rate as defined in the indenture. Based on the relative levels of these indices as of December 31, 2014, the rates expected to be paid by the Company range from 91-day T-Bill plus 125 basis points, on the low end, to LIBOR plus 250 basis points, on the high end. These maximum rates are subject to increase if the credit ratings on the bonds are downgraded.

#### *Unsecured Line of Credit*

The Company has a \$350.0 million unsecured line of credit that has a maturity date of June 30, 2019. As of December 31, 2014, the \$350.0 million unsecured line of credit had no amount outstanding and \$350.0 million was available for future use.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

The line of credit agreement contains certain financial covenants that, if not met, lead to an event of default under the agreement. The covenants include maintaining:

- A minimum consolidated net worth
- A minimum adjusted EBITDA to corporate debt interest (over the last four rolling quarters)
- A limitation on recourse indebtedness
- A limitation on the percentage of private education loans in the Company's portfolio

As of December 31, 2014, the Company was in compliance with all of these requirements. Many of these covenants are duplicated in the Company's other lending facilities, including its FFELP warehouse facilities.

The Company's operating line of credit does not have any covenants related to unsecured debt ratings. However, changes in the Company's ratings (as well as the amounts the Company borrows) have modest implications on the pricing level at which the Company obtains funding.

A default on the Company's FFELP warehouse facilities would result in an event of default on the Company's unsecured line of credit that would result in the outstanding balance on the line of credit becoming immediately due and payable.

***Junior Subordinated Hybrid Securities***

On September 27, 2006, the Company issued \$200.0 million aggregate principal amount of Junior Subordinated Hybrid Securities ("Hybrid Securities"). The Hybrid Securities are unsecured obligations of the Company. The interest rate on the Hybrid Securities through September 29, 2036 ("the scheduled maturity date") is equal to three-month LIBOR plus 3.375%, payable quarterly, which was 3.63% at December 31, 2014. The principal amount of the Hybrid Securities will become due on the scheduled maturity date only to the extent that prior to such date the Company has received proceeds from the sale of certain qualifying capital securities (as defined in the Hybrid Securities' indenture). If any amount is not paid on the scheduled maturity date, it will remain outstanding and bear interest at a floating rate as defined in the indenture, payable monthly. On September 15, 2061, the Company must pay any remaining principal and interest on the Hybrid Securities in full whether or not the Company has sold qualifying capital securities. At the Company's option, the Hybrid Securities are redeemable in whole or in part at their principal amount plus accrued and unpaid interest, provided in the case of a redemption in part that the principal amount outstanding after such redemption is at least \$50.0 million. As of December 31, 2014, the outstanding balance on the Hybrid Securities was \$71.7 million.

***Other Borrowings***

On April 12, 2012, the Company entered into a \$50.0 million line of credit, which is collateralized by asset-backed security investments. On October 31, 2014, the Company amended this facility to increase the borrowing capacity to \$75.0 million and extend the maturity date to October 31, 2016. The line of credit has covenants and cross default provisions similar to those under the Company's unsecured line of credit. As of December 31, 2014, \$75.0 million was outstanding on this line of credit.

On October 13, 2006, the Company purchased a building in which its corporate headquarters is located. In connection with the acquisition of the building, the Company assumed the outstanding note on the property. As of December 31, 2014 and 2013, the outstanding balance on the note was \$4.4 million and \$4.5 million, respectively.

On January 1, 2014, the Company subparticipated the Company's participation interest in a loan receivable. As of December 31, 2014, the participated portion of the loan was \$2.6 million, with an obligation to fund an additional \$0.5 million. The outstanding balance of the subparticipation agreement is included in bonds and notes payable.

As of December 31, 2013, bonds and notes payable included \$6.9 million of notes due to a third-party. The Company used the proceeds from these notes to invest in private education loan assets via a participation agreement. This participation was canceled in 2014.

## NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

One of the Company's education lending subsidiaries has irrevocably escrowed funds to make the remaining principal and interest payments on previously issued bonds and notes. Accordingly, neither these obligations nor the escrowed funds are included on the accompanying consolidated balance sheets. As of December 31, 2014 and 2013, the accreted defeased debt that remained outstanding was \$49.4 million and \$45.9 million, respectively.

### ***Debt Covenants***

Certain bond resolutions contain, among other requirements, covenants relating to restrictions on additional indebtedness, limits as to direct and indirect administrative expenses, and maintaining certain financial ratios. Management believes the Company is in compliance with all covenants of the bond indentures and related credit agreements as of December 31, 2014.

### ***Maturity Schedule***

Bonds and notes outstanding as of December 31, 2014 are due in varying amounts as shown below.

2015	\$	4,393
2016		767,613
2017		549,052
2018		39,265
2019		437,003
2020 and thereafter		26,623,096
	\$	<u>28,420,422</u>

Generally, the Company's secured financing instruments bearing interest at variable rates can be redeemed on any interest payment date at par plus accrued interest. Subject to certain provisions, all bonds and notes are subject to redemption prior to maturity at the option of certain education lending subsidiaries.

## **5. Derivative Financial Instruments**

The Company uses derivative financial instruments primarily to manage interest rate risk and foreign currency exchange risk.

### ***Interest Rate Risk***

The Company is exposed to interest rate risk in the form of basis risk and repricing risk because the interest rate characteristics of the Company's assets do not match the interest rate characteristics of the funding for those assets. The Company has adopted a policy of periodically reviewing the mismatch related to the interest rate characteristics of its assets and liabilities together with the Company's outlook as to current and future market conditions. Based on those factors, the Company uses derivative instruments as part of its overall risk management strategy. Derivative instruments used as part of the Company's interest rate risk management strategy currently include basis swaps and interest rate swaps.

### **Basis Swaps**

Interest earned on the majority of the Company's FFELP student loan assets is indexed to the one-month LIBOR rate. Meanwhile, the Company funds a majority of its assets with three-month LIBOR indexed floating rate securities. The different interest rate characteristics of the Company's loan assets and liabilities funding these assets results in basis risk.

The Company also faces repricing risk due to the timing of the interest rate resets on its liabilities, which may occur as infrequently as once a quarter, in contrast to the timing of the interest rate resets on its assets, which generally occur daily. As of December 31, 2014, the Company had \$27.3 billion and \$0.9 billion of FFELP loans indexed to the one-month LIBOR rate and the three-month treasury bill rate, respectively, the indices for which reset daily, and \$16.5 billion of debt indexed to three-month LIBOR, the indices for which reset quarterly, and \$9.9 billion of debt indexed to one-month LIBOR, the indices for which reset monthly.

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The Company has used derivative instruments to hedge its basis risk and repricing risk. The Company has entered into basis swaps in which the Company receives three-month LIBOR set discretely in advance and pays one-month LIBOR plus or minus a spread as defined in the agreements (the 1:3 Basis Swaps).

The following table summarizes the Company's 1:3 Basis Swaps outstanding:

	As of December 31,	
	2014	2013
Maturity	Notional amount	Notional amount
2021	\$ 250,000	250,000
2022	1,900,000	1,900,000
2023	3,650,000	3,650,000
2024	250,000	250,000
2026	800,000	800,000
2028	100,000	100,000
2036	700,000	700,000
2039 (a)	150,000	150,000
2040	—	200,000
	<u>\$ 7,800,000</u>	<u>(b) 8,000,000 (b)</u>

(a) This derivative has a forward effective start date in 2015.

(b) The weighted average rate paid by the Company on the 1:3 Basis Swaps as of December 31, 2014 and 2013, was one-month LIBOR plus 3.5 basis points.

## Interest rate swaps – floor income hedges

FFELP loans originated prior to April 1, 2006 generally earn interest at the higher of the borrower rate, which is fixed over a period of time, or a floating rate based on the Special Allowance Payments ("SAP") formula set by the Department. The SAP rate is based on an applicable index plus a fixed spread that depends on loan type, origination date, and repayment status. The Company generally finances its student loan portfolio with variable rate debt. In low and/or certain declining interest rate environments, when the fixed borrower rate is higher than the SAP rate, these student loans earn at a fixed rate while the interest on the variable rate debt typically continues to reflect the low and/or declining interest rates. In these interest rate environments, the Company may earn additional spread income that it refers to as floor income.

Depending on the type of loan and when it was originated, the borrower rate is either fixed to term or is reset to an annual rate each July 1. As a result, for loans where the borrower rate is fixed to term, the Company may earn floor income for an extended period of time, which the Company refers to as fixed rate floor income, and for those loans where the borrower rate is reset annually on July 1, the Company may earn floor income to the next reset date, which the Company refers to as variable rate floor income. All FFELP loans first originated on or after April 1, 2006 effectively earn at the SAP rate, since lenders are required to rebate fixed rate floor income and variable rate floor income for these loans to the Department.

Absent the use of derivative instruments, a rise in interest rates may reduce the amount of floor income received and this may have an impact on earnings due to interest margin compression caused by increasing financing costs, until such time as the federally insured loans earn interest at a variable rate in accordance with their SAP formulas. In higher interest rate environments, where the interest rate rises above the borrower rate and fixed rate loans effectively become variable rate loans, the impact of the rate fluctuations is reduced.

As of December 31, 2014 and 2013, the Company had \$12.7 billion and \$11.1 billion, respectively, of student loan assets that were earning fixed rate floor income, of which the weighted average estimated variable conversion rate for these loans, which is the estimated short-term interest rate at which loans would convert to a variable rate, was 1.84% and 1.83%, respectively.

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The following tables summarize the outstanding derivative instruments used by the Company to economically hedge loans earning fixed rate floor income.

Maturity	As of December 31, 2014		As of December 31, 2013	
	Notional amount	Weighted average fixed rate paid by the Company (a)	Notional amount	Weighted average fixed rate paid by the Company (a)
2014	\$ —	—%	\$ 1,750,000	0.71%
2015	1,100,000	0.89	1,100,000	0.89
2016	750,000	0.85	750,000	0.85
2017	1,250,000	0.86	1,250,000	0.86
	<u>\$ 3,100,000</u>	<u>0.87%</u>	<u>\$ 4,850,000</u>	<u>0.81%</u>

(a) For all interest rate derivatives, the Company receives discrete three-month LIBOR.

On August 20, 2014, the Company paid \$9.1 million for an interest rate swaption to economically hedge loans earning fixed rate floor income. The interest rate swap option gives the Company the right, but not the obligation, to enter into a \$250 million notional interest rate swap in which the Company would pay a fixed amount of 3.30% and receive discrete one-month LIBOR. If the interest rate swap option is exercised, the swap would become effective in 2019 and mature in 2024.

## Interest rate swaps – unsecured debt hedges

As of December 31, 2014 and 2013, the Company had \$71.7 million and \$96.5 million, respectively, of unsecured Hybrid Securities outstanding. The interest rate on the Hybrid Securities through September 29, 2036 is equal to three-month LIBOR plus 3.375%, payable quarterly. As of December 31, 2014 and 2013, the Company had the following derivatives outstanding that are used to effectively convert the variable interest rate on a portion of the Hybrid Securities to a fixed rate of 7.66%.

Maturity	Notional amount	Weighted average fixed rate paid by the Company (a)
2036	<u>\$ 25,000</u>	<u>4.28%</u>

(a) For all interest rate derivatives, the Company receives discrete three-month LIBOR.

## **Foreign Currency Exchange Risk**

In 2006, the Company issued €352.7 million of student loan asset-backed Euro Notes (the "Euro Notes") with an interest rate based on a spread to the EURIBOR index. As a result of the Euro Notes, the Company is exposed to market risk related to fluctuations in foreign currency exchange rates between the U.S. dollar and Euro. The principal and accrued interest on these notes are re-measured at each reporting period and recorded in the Company's consolidated balance sheet in U.S. dollars based on the foreign currency exchange rate on that date. Changes in the principal and accrued interest amounts as a result of foreign currency exchange rate fluctuations are included in the Company's consolidated statements of income.

The Company entered into a cross-currency interest rate swap in connection with the issuance of the Euro Notes. Under the terms of the cross-currency interest rate swap, the Company receives from the counterparty a spread to the EURIBOR index based on a notional amount of €352.7 million and pays a spread to the LIBOR index based on a notional amount of \$450.0 million. In addition, under the terms of this agreement, all principal payments on the Euro Notes will effectively be paid at the exchange rate in effect between the U.S. dollar and Euro as of the issuance of the notes.

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The following table shows the income statement impact as a result of the re-measurement of the Euro Notes and the change in the fair value of the related derivative instruments.

	Year ended December 31,		
	2014	2013 (b)	2012 (b)
Re-measurement of Euro Notes	\$ 58,013	(35,285)	(19,561)
Change in fair value of cross currency interest rate swaps	(57,289)	26,354	2,210
Total impact to consolidated statements of income - income (expense) (a)	\$ 724	(8,931)	(17,351)

- (a) The financial statement impact of the above items is included in "Derivative market value and foreign currency adjustments and derivative settlements, net" in the Company's consolidated statements of income.
- (b) The 2013 and 2012 operating results include the re-measurement of an additional €420.5 million of student loan asset-backed Euro notes and the change in fair value of a related cross-currency interest rate swap entered into in connection with the issuance of such notes. In November 2013, the principal amount outstanding on the notes was changed to U.S. dollars and the cross-currency interest rate swap was terminated.

The re-measurement of the Euro-denominated bonds generally correlates with the change in fair value of the corresponding cross-currency interest rate swap. However, the Company will experience unrealized gains or losses related to the cross-currency interest rate swap if the two underlying indices (and related forward curve) do not move in parallel.

## Consolidated Financial Statement Impact Related to Derivatives

The following table summarizes the fair value of the Company's derivatives as reflected on the consolidated balance sheet.

	Fair value of asset derivatives		Fair value of liability derivatives	
	As of December 31, 2014	As of December 31, 2013	As of December 31, 2014	As of December 31, 2013
1:3 basis swaps	\$ 53,549	18,490	—	—
Interest rate swaps - floor income hedges	5,165	7,183	5,034	15,849
Interest rate swap option - floor income hedge	5,678	—	—	—
Interest rate swaps - hybrid debt hedges	—	—	7,353	2,120
Cross-currency interest rate swap	—	36,834	20,455	—
Total	\$ 64,392	62,507	32,842	17,969

During the years ended December 31, 2014 and 2013, the Company terminated certain derivatives for net proceeds of \$1.8 million and \$65.9 million, respectively.

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

Offsetting of Derivative Assets/Liabilities

The Company records derivative instruments in the consolidated balance sheets on a gross basis as either an asset or liability measured at its fair value. Certain of the Company's derivative instruments are subject to right of offset provisions with counterparties. The following tables include the gross amounts related to the Company's derivative portfolio recognized in the consolidated balance sheets, reconciled to the net amount when excluding derivatives subject to enforceable master netting arrangements and cash collateral received/pledged:

Derivative assets	Gross amounts of recognized assets presented in the consolidated balance sheets	Gross amounts not offset in the consolidated balance sheets			Net asset (liability)
		Derivatives subject to enforceable master netting arrangement	Cash collateral received		
Balance as of December 31, 2014	\$ 64,392	(12,387)	—		52,005
Balance as of December 31, 2013	62,507	(15,437)	(15,959)		31,111

Derivative liabilities	Gross amounts of recognized liabilities presented in the consolidated balance sheets	Gross amounts not offset in the consolidated balance sheets			Net asset (liability)
		Derivatives subject to enforceable master netting arrangement	Cash collateral pledged (received)		
Balance as of December 31, 2014	\$ (32,842)	12,387	(1,454)		(21,909)
Balance as of December 31, 2013	(17,969)	15,437	3,630		1,098

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

The following table summarizes the effect of derivative instruments in the consolidated statements of income.

	Year ended December 31,		
	2014	2013	2012
<b>Settlements:</b>			
1:3 basis swaps	\$ 3,389	3,301	4,495
Interest rate swaps - floor income hedges	(24,380)	(31,022)	(19,270)
Interest rate swaps - hybrid debt hedges	(1,025)	(1,670)	(2,231)
Cross-currency interest rate swaps	173	(245)	3,228
Other	—	—	(244)
Total settlements - (expense) income	(21,843)	(29,636)	(14,022)
<b>Change in fair value:</b>			
1:3 basis swaps	36,824	7,467	676
Interest rate swaps - floor income hedges	8,797	36,719	(35,215)
Interest rate swap option - floor income hedge	(3,409)	—	—
Interest rate swaps - hybrid debt hedges	(5,233)	12,997	1,717
Cross-currency interest rate swaps	(57,289)	26,354	2,210
Other	—	341	2,779
Total change in fair value - (expense) income	(20,310)	83,878	(27,833)
Re-measurement of Euro Notes (foreign currency transaction adjustment) - income (expense)	58,013	(35,285)	(19,561)
Derivative market value and foreign currency adjustments and derivative settlements, net - income (expense)	\$ 15,860	18,957	(61,416)

***Derivative Instruments - Credit and Market Risk***

By using derivative instruments, the Company is exposed to credit and market risk. The Company manages credit and market risks associated with interest rates by establishing and monitoring limits as to the types and degree of risk that may be undertaken and by entering into transactions with high-quality counterparties that are reviewed periodically by the Company's risk committee. As of December 31, 2014, all of the Company's derivative counterparties had investment grade credit ratings. The Company also has a policy of requiring that all derivative contracts be governed by an International Swaps and Derivatives Association, Inc. Master Agreement.

***Credit Risk***

When the fair value of a derivative contract is positive (an asset in the Company's consolidated balance sheet), this generally indicates that the counterparty would owe the Company if the derivative was settled. If the counterparty fails to perform, credit risk with such counterparty is equal to the extent of the fair value gain in the derivative less any collateral held by the Company. If the Company was unable to collect from a counterparty, it would have a loss equal to the amount the derivative is recorded in the consolidated balance sheet.

The Company considers counterparties' credit risk when determining the fair value of derivative positions on its exposure net of collateral. However, the Company does not use the collateral to offset fair value amounts recognized for derivative instruments in the financial statements.

***Market Risk***

When the fair value of a derivative instrument is negative (a liability in the Company's consolidated balance sheet), the Company would owe the counterparty if the derivative was settled and, therefore, has no immediate credit risk. If the negative fair value of derivatives with a counterparty exceeds a specified threshold, the Company may have to make a collateral deposit with the counterparty. The threshold at which the Company may be required to post collateral is dependent upon the Company's unsecured credit rating. The Company believes any downgrades from its current unsecured credit rating (Standard & Poor's: BBB- (stable



# NELNET, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

outlook) and Moody's: Ba1 (stable outlook)), would not result in additional collateral requirements of a material nature. In addition, no counterparty has the right to terminate its contracts in the event of downgrades from the current rating. However, some derivative contracts have mutual optional termination provisions that can be exercised during the years 2016 through 2023. As of December 31, 2014, the fair value of derivatives with early termination provisions was a positive \$34.7 million (an asset in the Company's consolidated balance sheet).

Interest rate movements have an impact on the amount of collateral the Company is required to deposit with its derivative instrument counterparties. With the Company's current derivative portfolio, the Company does not currently anticipate near term movement in interest rates having a material impact on its liquidity or capital resources, nor expects future movements in interest rates to have a material impact on its ability to meet potential collateral deposits with its counterparties. Due to the existing low interest rate environment, the Company's exposure to downward movements in interest rates on its interest rate swaps is limited. In addition, the historical high correlation between one-month and three-month LIBOR limits the Company's exposure to interest rate movements on the 1:3 Basis Swaps.

The Company's cross-currency interest rate swap was entered into as a result of an asset-backed security financing and was entered into at the securitization trust level with the counterparty. Trust related derivatives do not contain credit contingent features related to the Company or the trust's credit ratings. As such, there are no collateral requirements and as a result the impact of changes to foreign currency rates has no impact on the amount of collateral the Company would be required to deposit with the counterparty on this derivative.

### 6. Investments

A summary of the Company's investments and restricted investments follows:

	As of December 31, 2014				As of December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses (a)	Fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>Investments:</b>								
Available-for-sale investments:								
Student loan asset-backed and other debt securities (b)	\$ 131,589	6,204	(236)	137,557	171,931	7,111	(1,241)	177,801
Equity securities	1,553	2,216	(33)	3,736	1,502	1,783	(3)	3,282
Total available-for-sale investments	<u>\$ 133,142</u>	<u>8,420</u>	<u>(269)</u>	<u>141,293</u>	<u>173,433</u>	<u>8,894</u>	<u>(1,244)</u>	<u>181,083</u>
Trading investments:								
Student loan asset-backed securities				7,830				10,957
Total available-for-sale and trading investments				<u>\$ 149,123</u>				<u>192,040</u>
<b>Restricted Investments (c):</b>								
Guaranteed investment contracts - held-to-maturity				<u>\$ 50,276</u>				<u>7,285</u>

(a) As of December 31, 2014, the Company considered the decline in market value of its available-for-sale investments to be temporary in nature and did not consider any of its investments other-than-temporarily impaired.

(b) As of December 31, 2014, the stated maturities of the Company's student loan asset-backed securities and other debt securities classified as available-for-sale are shown in the following table:

Year of Maturity:	Amortized cost	Fair value
Within 1 year	\$ —	—
1-5 years	386	386
6-10 years	—	—
After 10 years	131,203	137,171
Total	<u>\$ 131,589</u>	<u>137,557</u>

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

- (c) Restricted investments are included in "restricted cash and investments" in the Company's consolidated balance sheets. The Company's restricted investments include cash balances that the Company's indentured securitization trusts deposit in guaranteed investment contracts that are held for the related note holders. These investments are classified as held-to-maturity and the Company accounts for them at amortized cost, which approximates fair value.

As of December 31, 2014, the stated maturities of the Company's restricted investments, which are classified as held-to-maturity, are shown in the following table.

## Year of Maturity:

Within 1 year	\$	—
1-5 years		10,203
6-10 years		—
After 10 years		40,073
Total	\$	<u>50,276</u>

T

The following table summarizes the amount included in "other income" in the consolidated statements of income related to the Company's investments classified as available-for-sale and trading.

	Year ended December 31,		
	2014	2013	2012
Available-for-sale securities:			
Gross realized gains	\$ 8,581	6,270	6,120
Gross realized losses	(75)	(332)	(322)
Trading securities:			
Unrealized (losses) gains, net	(135)	221	254
Realized (losses) gains, net	(1,082)	5	1,459
	<u>\$ 7,289</u>	<u>6,164</u>	<u>7,511</u>

The amounts reclassified from accumulated other comprehensive income related to the realized gains and losses on available-for-sale-securities is summarized below.

Affected line item in the consolidated statements of income - income (expense):	Year ended December 31,		
	2014	2013	2012
Other income	\$ 8,506	5,938	5,798
Income tax expense	(3,147)	(2,197)	(2,145)
Net income	<u>\$ 5,359</u>	<u>3,741</u>	<u>3,653</u>

## 7. Business Combination

### *Wilcomp Software, L.P. (d.b.a. RenWeb School Management Software) ("RenWeb")*

On June 3, 2014, the Company purchased 100 percent of the ownership interests of RenWeb. RenWeb provides school information systems for private and faith-based schools that help schools automate administrative processes such as admissions, scheduling, student billing, attendance, and grade book management. The combination of RenWeb's school administration software and the Company's tuition management and financial needs assessment services is expected to significantly increase the value of the Company's offerings in this area, allowing the Company to deliver a comprehensive suite of solutions to schools.

The initial consideration paid by the Company for RenWeb was \$44.0 million. In addition to the initial purchase price, additional payments are to be paid by the Company to the former owners of RenWeb based on certain operating results and other performance measures of RenWeb as defined in the purchase agreement. The contingent payments, if any, are payable when earned, and the

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

potential undiscounted amount of all future payments that the Company could be required to make under the contingent consideration arrangement is between \$0 and \$4.0 million . Such payments, if any, will be paid no later than January 2017. As of the acquisition date, the Company accrued \$2.3 million as additional consideration, which represented the estimated fair value of the contingent consideration arrangement. In December 2014, the Company reduced the estimated fair value of the contingent consideration by \$1.3 million .

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date.

Cash and cash equivalents	\$	326
Accounts receivable		961
Property and equipment		105
Other assets		22
Intangible assets		37,188
Excess cost over fair value of net assets acquired (goodwill)		9,082
Other liabilities		(1,341)
Net assets acquired	\$	46,343

The \$37.2 million of acquired intangible assets on the date of acquisition had a weighted-average useful life of approximately 18 years . The intangible assets that made up this amount included customer relationships of \$25.5 million ( 20 -year useful life), trade name of \$6.4 million ( 20 -year useful life), computer software of \$4.9 million ( 5 -year useful life), and non-competition agreements of \$0.4 million ( 10 -year useful life).

The \$9.1 million of goodwill was assigned to the Tuition Payment Processing and Campus Commerce operating segment and is expected to be deductible for tax purposes. The amount allocated to goodwill was primarily attributable to anticipated synergies as discussed previously.

The proforma impacts of the acquisition on the Company's historical results prior to the acquisition were not material.

## 8. Intangible Assets

Intangible assets consist of the following:

	Weighted average remaining useful life as of December 31, 2014 (months)	As of December 31, 2014	As of December 31, 2013
Amortizable intangible assets:			
Customer relationships (net of accumulated amortization of \$17,361 and \$19,821, respectively)	209	\$ 27,330	6,132
Computer software (net of accumulated amortization of \$1,896 and \$0, respectively)	42	6,969	—
Trade names (net of accumulated amortization of \$272 and \$0, respectively)	233	6,150	—
Content (net of accumulated amortization of \$0)	24	1,800	—
Covenants not to compete (net of accumulated amortization of \$21 and \$0, respectively)	113	333	—
Total - amortizable intangible assets	176	\$ 42,582	6,132

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The Company recorded amortization expense on its intangible assets of \$6.5 million , \$3.3 million , and \$19.0 million during the years ended December 31, 2014, 2013, and 2012 , respectively. The Company will continue to amortize intangible assets over their remaining useful lives. As of December 31, 2014 , the Company estimates it will record amortization expense as follows:

2015	\$	8,695
2016		6,249
2017		4,652
2018		3,533
2019		2,861
2020 and thereafter		16,592
	\$	<u>42,582</u>

## 9. Goodwill

The change in the carrying amount of goodwill by reportable operating segment was as follows:

	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Asset Generation and Management (a)	Corporate and Other Activities	Total
Balance as of December 31, 2012 and 2013	\$ 8,596	58,086	41,883	8,553	117,118
Goodwill acquired during the period	—	9,082	—	—	9,082
Balance as of December 31, 2014	<u>\$ 8,596</u>	<u>67,168</u>	<u>41,883</u>	<u>8,553</u>	<u>126,200</u>

- (a) As a result of the Reconciliation Act of 2010, the Company no longer originates new FFELP loans, and net interest income from the Company's existing FFELP loan portfolio will decline over time as the Company's portfolio pays down. As a result, as this revenue stream winds down, goodwill impairment will be triggered for the Asset Generation and Management reporting unit due to the passage of time and depletion of projected cash flows stemming from its FFELP student loan portfolio. Management believes the elimination of new FFELP loan originations will not have an adverse impact on the fair value of the Company's other reporting units.

The Company reviews goodwill for impairment annually. This annual review is completed by the Company as of November 30 of each year and whenever triggering events or changes in circumstances indicate its carrying value may not be recoverable.

For the 2012 , 2013 , and 2014 annual review of goodwill, the Company assessed qualitative factors and concluded it was not more likely than not that the fair value of its reporting units were less than their carrying amount. As such, the Company was not required to perform the two-step impairment test and concluded there was no impairment of goodwill.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

**10. Property and Equipment**

Property and equipment consisted of the following:

	Useful life	As of December 31,	
		2014	2013
Computer equipment and software	1-5 years	\$ 98,462	77,733
Office furniture and equipment	3-7 years	12,265	9,843
Leasehold improvements	1-15 years	3,645	3,618
Transportation equipment	10 years	3,877	7,398
Building and building improvements	5-39 years	11,336	10,366
Land	—	700	700
		130,285	109,658
Accumulated depreciation		84,391	75,829
		<u>\$ 45,894</u>	<u>33,829</u>

Depreciation expense for the years ended December 31, 2014 , 2013 , and 2012 related to property and equipment was \$14.6 million , \$15.1 million , and \$12.9 million , respectively.

**11. Shareholders' Equity**

*Classes of Common Stock*

The Company's common stock is divided into two classes. The Class B common stock has ten votes per share and the Class A common stock has one vote per share on all matters to be voted on by the Company's shareholders. Each Class B share is convertible at any time at the holder's option into one Class A share. With the exception of the voting rights and the conversion feature, the Class A and Class B shares are identical in terms of other rights, including dividend and liquidation rights.

*Stock Repurchases*

The Company has a stock repurchase program that expires on May 24, 2015 in which it can repurchase up to five million shares of its Class A common stock on the open market, through private transactions, or otherwise. As of December 31, 2014 , 3.5 million shares may still be purchased under the Company's stock repurchase program. Shares repurchased by the Company during 2014 , 2013 , and 2012 are shown in the table below.

	Total shares repurchased	Purchase price (in thousands)	Average price of shares repurchased (per share)
Year ended December 31, 2014	381,689	\$ 15,713	\$ 41.17
Year ended December 31, 2013	393,259	13,136	33.40
Year ended December 31, 2012	806,023	22,814	28.30

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

## 12. Earnings per Common Share

Presented below is a summary of the components used to calculate basic and diluted earnings per share. The Company applies the two-class method in computing both basic and diluted earnings per share, which requires the calculation of separate earnings per share amounts for common stock and unvested share-based awards. Unvested share-based awards that contain nonforfeitable rights to dividends are considered securities which participate in undistributed earnings with common stock.

	Year ended December 31,								
	2014			2013			2012		
	Common shareholders	Unvested restricted stock shareholders	Total	Common shareholders	Unvested restricted stock shareholders	Total	Common shareholders	Unvested restricted stock shareholders	Total
Numerator:									
Net income attributable to Nelnet, Inc.	\$ 304,540	3,070	307,610	300,043	2,629	302,672	176,647	1,350	177,997
Denominator:									
Weighted-average common shares outstanding - basic and diluted	46,005,915	463,700	46,469,615	46,165,785	404,529	46,570,314	47,010,034	359,297	47,369,331
Earnings per share - basic and diluted	\$ 6.62	6.62	6.62	6.50	6.50	6.50	3.76	3.76	3.76

Unvested restricted stock awards are the Company's only potential common shares and, accordingly, there were no awards that were antidilutive and not included in average shares outstanding for the diluted earnings per share calculation.

As of December 31, 2014, a cumulative amount of 136,495 shares have been deferred by non-employee directors under the Directors Stock Compensation Plan and will become issuable upon the termination of service by the respective non-employee director on the board of directors. These shares are included in the Company's weighted average shares outstanding calculation.

## 13. Income Taxes

The Company is subject to income taxes in the United States, Canada, and Australia. Significant judgment is required in evaluating the Company's tax positions and determining the provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain.

As required by the Income Taxes Topic of the FASB Accounting Standards Codification, the Company recognizes in the consolidated financial statements only those tax positions determined to be more likely than not of being sustained upon examination, based on the technical merits of the positions. It further requires that a change in judgment related to the expected ultimate resolution of uncertain tax positions be recognized in earnings in the period of such change.

# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

As of December 31, 2014, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$21.3 million, which is included in “other liabilities” on the consolidated balance sheet. Of this total, \$13.9 million (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate in future periods. The Company currently anticipates uncertain tax positions will decrease by \$3.7 million prior to December 31, 2015 as a result of a lapse of applicable statutes of limitations, settlements, correspondence with examining authorities, and recognition or measurement considerations with federal and state jurisdictions; however, actual developments in this area could differ from those currently expected. Of the anticipated \$3.7 million decrease, \$2.4 million, if recognized, would favorably affect the Company's effective tax rate. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits follows:

	Year ended December 31,	
	2014	2013
Gross balance - beginning of year	\$ 19,141	29,568
Additions based on tax positions of prior years	1,421	996
Additions based on tax positions related to the current year	4,393	3,812
Settlements with taxing authorities	(833)	(7,470)
Reductions for tax positions of prior years	(641)	(6,470)
Reductions based on tax positions related to the current year	—	(272)
Reductions due to lapse of applicable statutes of limitations	(2,145)	(1,023)
Gross balance - end of year	\$ 21,336	19,141

All the reductions shown in the table above that are due to prior year tax positions and the lapse of statutes of limitations impacted the effective tax rate.

The Company's policy is to recognize interest and penalties accrued on uncertain tax positions as part of interest expense and other expense, respectively. As of both December 31, 2014 and 2013, \$2.1 million in accrued interest and penalties were included in “other liabilities” on the consolidated balance sheets. The Company recognized a decrease to interest expense related to uncertain tax positions of \$1.3 million for the year ended December 31, 2013, and interest expense of \$0.1 million and \$2.7 million for the years ended December 31, 2014 and 2012 respectively. The Company reversed accrued penalties related to uncertain tax positions of \$0.3 million in 2013 as a result of exam closures and statutes of limitation lapses. No penalties were accrued in 2014 and 2012. The impact of timing differences and tax attributes are considered when calculating interest and penalty accruals associated with the unrecognized tax benefits.

The Company and its subsidiaries file a consolidated federal income tax return in the U.S. and the Company or one of its subsidiaries files income tax returns in various state, local, and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations for years prior to 2011. The Company is no longer subject to U.S. state/local income tax examinations by tax authorities prior to 2007. As of December 31, 2014, the Company has significant tax uncertainties that remain unsettled in the following jurisdictions:

California	2010 through 2012
New York	2008 through 2011
Texas	2007 through 2009

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The provision for income taxes consists of the following components:

	Year ended December 31,		
	2014	2013	2012
<b>Current:</b>			
Federal	\$ 138,269	153,756	118,490
State	2,545	4,776	1,383
Foreign	(235)	122	33
Total current provision	140,579	158,654	119,906
<b>Deferred:</b>			
Federal	16,598	1,676	(23,460)
State	3,464	868	(358)
Foreign	(403)	(5)	(11)
Total deferred provision (benefit)	19,659	2,539	(23,829)
Provision for income tax expense	\$ 160,238	161,193	96,077

The differences between the income tax provision computed at the statutory federal corporate tax rate and the financial statement provision for income taxes are shown below:

	Year ended December 31,		
	2014	2013	2012
Tax expense at federal rate	35.0%	35.0%	35.0%
Increase (decrease) resulting from:			
State tax, net of federal income tax benefit	0.7	0.8	0.5
Provision for uncertain federal and state tax matters	0.4	(0.6)	0.2
Tax credits	(0.4)	(0.4)	(0.6)
Other	(1.4)	—	(0.1)
Effective tax rate	34.3%	34.8%	35.0%

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**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The tax effect of temporary differences that give rise to deferred tax assets and liabilities include the following:

	As of December 31,	
	2014	2013
Deferred tax assets:		
Student loans	\$ 21,139	25,967
Intangible assets	12,682	23,675
Securitizations	7,626	10,407
Capital loss carry-back	3,974	—
Accrued expenses	2,872	4,162
Stock compensation	2,490	1,608
Deferred revenue	1,548	777
Other	109	28
Total gross deferred tax assets	52,440	66,624
Less valuation allowance	(304)	(239)
Net deferred tax assets	52,136	66,385
Deferred tax liabilities:		
Debt repurchases	24,918	32,286
Loan origination services	19,258	23,750
Basis in certain derivative contracts	15,692	2,137
Depreciation	4,122	4,673
Unrealized gain on debt and equity securities	3,016	2,830
Partnership basis	1,143	—
Total gross deferred tax liabilities	68,149	65,676
Net deferred tax (liability) asset	\$ (16,013)	709

The Company has performed an evaluation of the recoverability of deferred tax assets. In assessing the realizability of the Company's deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which those temporary differences become deductible. Management considers the scheduled reversals of deferred tax liabilities, projected taxable income, carry back opportunities, and tax planning strategies in making the assessment of the amount of the valuation allowance. With the exception of a portion of the Company's state net operating loss, it is management's opinion that it is more likely than not that the deferred tax assets will be realized and should not be reduced by a valuation allowance. The amount of deferred tax assets considered realizable could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

Included on the balance sheet at December 31, 2014 and 2013 was a current income tax receivable of \$10.2 million and a current income tax payable of \$4.1 million, respectively.

#### **14. Segment Reporting**

The Company has three reportable operating segments. The Company's reportable operating segments include:

- Student Loan and Guaranty Servicing
- Tuition Payment Processing and Campus Commerce
- Asset Generation and Management

The Company earns fee-based revenue through its Student Loan and Guaranty Servicing and Tuition Payment Processing operating segments. In addition, the Company earns interest income on its student loan portfolio in its Asset Generation and Management operating segment. The Company's operating segments are defined by the products and services they offer and the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. See note 1, "Description of Business," for a description of each operating segment, including the primary products and services offered.

In 2014, management determined that the Company's Enrollment Services business no longer met the quantitative thresholds for which separate information about an operating segment is required. Prior period segment operating results were restated to conform to the current period presentation.

The management reporting process measures the performance of the Company's operating segments based on the management structure of the Company, as well as the methodology used by management to evaluate performance and allocate resources. Executive management (the "chief operating decision maker") evaluates the performance of the Company's operating segments based on their financial results prepared in conformity with U.S. GAAP.

The accounting policies of the Company's operating segments are the same as those described in the summary of significant accounting policies. Intersegment revenues are charged by a segment that provides a product or service to another segment. Intersegment revenues and expenses are included within each segment consistent with the income statement presentation provided to management. Income taxes are allocated based on 38% of income before taxes for each individual operating segment. The difference between the consolidated income tax expense and the sum of taxes calculated for each operating segment is included in income taxes in Corporate and Other Activities.

##### ***Corporate and Other Activities***

Other business activities and operating segments that are not reportable are combined and included in Corporate and Other Activities. Corporate and Other Activities includes the following items:

- Income earned on certain investment activities
- Interest expense incurred on unsecured debt transactions
- Other product and service offerings that are not considered reportable operating segments including, but not limited to, WRCM, the SEC-registered investment advisory subsidiary, and the Enrollment Services business

Corporate and Other Activities also includes certain corporate activities and overhead functions related to executive management, human resources, accounting, legal, enterprise risk management, occupancy, and marketing. These costs are allocated to each operating segment based on estimated use of such activities and services.

##### ***Segment Results***

The following tables include the results of each of the Company's reportable operating segments reconciled to the consolidated financial statements.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

	Year ended December 31, 2014					
	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Asset Generation and Management	Corporate and Other Activities	Eliminations	Total
Total interest income	\$ 30	6	703,382	8,618	(2,236)	709,800
Interest expense	—	—	269,742	5,731	(2,236)	273,237
Net interest income	30	6	433,640	2,887	—	436,563
Less provision for loan losses	—	—	9,500	—	—	9,500
Net interest income after provision for loan losses	30	6	424,140	2,887	—	427,063
Other income (expense):						
Loan and guaranty servicing revenue	240,414	—	—	—	—	240,414
Intersegment servicing revenue	55,139	—	—	—	(55,139)	—
Tuition payment processing, school information, and campus commerce revenue	—	98,156	—	—	—	98,156
Enrollment services revenue	—	—	—	82,883	—	82,883
Other income	—	1,268	21,532	31,202	—	54,002
Gain on sale of loans and debt repurchases, net	—	—	(1,357)	5,008	—	3,651
Derivative market value and foreign currency adjustments, net	—	—	42,935	(5,232)	—	37,703
Derivative settlements, net	—	—	(20,818)	(1,025)	—	(21,843)
Total other income (expense)	295,553	99,424	42,292	112,836	(55,139)	494,966
Operating expenses:						
Salaries and benefits	138,584	48,453	2,316	38,726	—	228,079
Cost to provide enrollment services	—	—	—	53,307	—	53,307
Depreciation and amortization	10,742	8,169	—	2,223	—	21,134
Other	70,211	13,006	33,611	33,162	—	149,990
Intersegment expenses, net	4,208	5,864	55,808	(10,741)	(55,139)	—
Total operating expenses	223,745	75,492	91,735	116,677	(55,139)	452,510
Income (loss) before income taxes and corporate overhead allocation	71,838	23,938	374,697	(954)	—	469,519
Corporate overhead allocation	(9,029)	(3,010)	(5,017)	17,056	—	—
Income before income taxes	62,809	20,928	369,680	16,102	—	469,519
Income tax (expense) benefit	(23,867)	(7,952)	(140,477)	12,058	—	(160,238)
Net income	38,942	12,976	229,203	28,160	—	309,281
Net income attributable to noncontrolling interest	—	—	—	1,671	—	1,671
Net income attributable to Nelnet, Inc.	\$ 38,942	12,976	229,203	26,489	—	307,610
Total assets	\$ 84,495	231,991	29,505,439	497,147	(220,929)	30,098,143

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

	<b>Year ended December 31, 2013</b>					
	<b>Student Loan and Guaranty Servicing</b>	<b>Tuition Payment Processing and Campus Commerce</b>	<b>Asset Generation and Management</b>	<b>Corporate and Other Activities</b>	<b>Eliminations</b>	<b>Total</b>
Total interest income	\$ 40	—	638,604	9,433	(3,267)	644,810
Interest expense	—	—	229,533	4,669	(3,267)	230,935
Net interest income	40	—	409,071	4,764	—	413,875
Less provision for loan losses	—	—	18,500	—	—	18,500
Net interest income after provision for loan losses	40	—	390,571	4,764	—	395,375
Other income (expense):						
Loan and guaranty servicing revenue	243,428	—	—	—	—	243,428
Intersegment servicing revenue	56,744	—	—	—	(56,744)	—
Tuition payment processing, school information, and campus commerce revenue	—	80,682	—	—	—	80,682
Enrollment services revenue	—	—	—	98,078	—	98,078
Other income	—	—	15,223	32,218	(1,143)	46,298
Gain on sale of loans and debt repurchases	—	—	11,004	695	—	11,699
Derivative market value and foreign currency adjustments, net	—	—	35,256	13,337	—	48,593
Derivative settlements, net	—	—	(27,966)	(1,670)	—	(29,636)
Total other income (expense)	300,172	80,682	33,517	142,658	(57,887)	499,142
Operating expenses:						
Salaries and benefits	119,092	37,575	2,292	37,210	—	196,169
Cost to provide enrollment services	—	—	—	64,961	—	64,961
Depreciation and amortization	11,419	4,518	—	2,374	—	18,311
Other	79,116	9,147	30,945	31,477	(1,143)	149,542
Intersegment expenses, net	4,359	5,989	57,572	(11,176)	(56,744)	—
Total operating expenses	213,986	57,229	90,809	124,846	(57,887)	428,983
Income before income taxes and corporate overhead allocation	86,226	23,453	333,279	22,576	—	465,534
Corporate overhead allocation	(6,150)	(1,957)	(3,896)	12,003	—	—
Income before income taxes	80,076	21,496	329,383	34,579	—	465,534
Income tax (expense) benefit	(30,430)	(8,168)	(125,165)	2,570	—	(161,193)
Net income	49,646	13,328	204,218	37,149	—	304,341
Net income attributable to noncontrolling interest	—	—	—	1,669	—	1,669
Net income attributable to Nelnet, Inc.	\$ 49,646	13,328	204,218	35,480	—	302,672
Total assets	\$ 84,986	219,064	27,387,461	425,959	(346,621)	27,770,849

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

	Year ended December 31, 2012					
	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Asset Generation and Management	Corporate and Other Activities	Eliminations	Total
Total interest income	\$ 53	8	610,194	7,305	(3,707)	613,853
Interest expense	—	—	263,788	8,485	(3,707)	268,566
Net interest income	53	8	346,406	(1,180)	—	345,287
Less provision for loan losses	—	—	21,500	—	—	21,500
Net interest income after provision for loan losses	53	8	324,906	(1,180)	—	323,787
Other income (expense):						
Loan and guaranty servicing revenue	209,748	—	—	—	—	209,748
Intersegment servicing revenue	65,376	—	—	—	(65,376)	—
Tuition payment processing, school information, and campus commerce revenue	—	74,410	—	—	—	74,410
Enrollment services revenue	—	—	—	117,925	—	117,925
Other income	—	—	18,219	21,257	—	39,476
Gain on sale of loans and debt repurchases	—	—	3,814	325	—	4,139
Derivative market value and foreign currency adjustments, net	—	—	(51,809)	4,415	—	(47,394)
Derivative settlements, net	—	—	(11,792)	(2,230)	—	(14,022)
Total other income (expense)	275,124	74,410	(41,568)	141,692	(65,376)	384,282
Operating expenses:						
Salaries and benefits	115,126	34,314	2,252	41,134	—	192,826
Cost to provide enrollment services	—	—	—	78,375	—	78,375
Depreciation and amortization	18,415	7,240	—	7,970	—	33,625
Other	70,505	10,439	16,435	31,359	—	128,738
Intersegment expenses, net	5,280	5,383	66,215	(11,502)	(65,376)	—
Total operating expenses	209,326	57,376	84,902	147,336	(65,376)	433,564
Income (loss) before income taxes and corporate overhead allocation	65,851	17,042	198,436	(6,824)	—	274,505
Corporate overhead allocation	(5,904)	(1,968)	(5,306)	13,178	—	—
Income before income taxes	59,947	15,074	193,130	6,354	—	274,505
Income tax (expense) benefit	(22,780)	(5,728)	(73,387)	5,818	—	(96,077)
Net income	37,167	9,346	119,743	12,172	—	178,428
Net income attributable to noncontrolling interest	—	—	—	431	—	431
Net income attributable to Nelnet, Inc.	\$ 37,167	9,346	119,743	11,741	—	177,997
Total assets	\$ 90,959	150,600	26,463,551	260,905	(358,120)	26,607,895

## 15. Major Customer

The Company earns loan servicing revenue from a servicing contract with the Department that currently expires on June 16, 2019. Revenue earned by the Company's Student Loan and Guaranty Servicing operating segment related to this contract was \$124.4 million, \$97.4 million, and \$69.5 million for the years ended December 31, 2014, 2013, and 2012, respectively.

## 16. Legal Proceedings and Regulatory Matters

### *Legal Proceedings*

#### General

The Company is subject to various legal proceedings that arise in the normal course of business, including the legal proceedings discussed below. These matters frequently involve claims by student loan borrowers disputing the manner in which their student loans have been serviced or the accuracy of reports to credit bureaus, claims by student loan borrowers or other consumers alleging that state or Federal consumer protection laws have been violated in the process of collecting loans or conducting other business activities, and disputes with other business entities. From time to time, lawsuits may be brought as, or subsequently amended to assert claims in the form of, putative class action cases.



In evaluating each of its legal proceedings, the Company considers many factors that involve significant risks and uncertainties inherent in the overall litigation process, including (i) the amount of damages and the nature of any other relief sought in the proceeding, if specified; (ii) whether the proceeding is at an early stage; (iii) the impact of discovery; (iv) whether novel or unsettled legal theories are at issue; (v) the outcome of pending motions or appeals; (vi) whether there are significant factual issues to be resolved; (vii) whether class action status is sought and the Company's views of the likelihood of a class being certified by the court and the ultimate size of the class; (viii) the jurisdiction in which the proceeding is pending; (ix) the Company's views of the merits of the claims and of the strength of the Company's defenses; and (x) the progress of any negotiations with opposing parties. In assessing whether a legal proceeding may be material, the Company considers these and other quantitative and qualitative factors, including whether disclosure of the proceeding might be important to a reader of the Company's financial statements in light of all of the information about the Company that is available to the reader.

*Actions Requesting Certifications of Classes*

Proceedings or complaints that involve or ask for certifications of classes generally expand the scope of legal defense costs, as well as alleged potential claim amounts. The Company is currently subject to legal proceedings in which the plaintiffs have made allegations that one or more putative classes should be certified by the applicable court. With respect to the three proceedings specifically discussed below, it is significant to note that two matters have been settled and terminated for immaterial amounts, no putative class has actually been certified in the other proceeding still pending, the Company's position is that class certification would be inappropriate in that pending proceeding, and the Company has been granted a motion for a summary judgment dismissing the case and intends to vigorously contest the appeal and class certification in the remaining matter.

*Bais Yaakov of Spring Valley v. Peterson's Nelnet, LLC*

On January 4, 2011, a complaint against Peterson's Nelnet, LLC ("Peterson's"), a subsidiary of Nelnet, Inc. ("Nelnet"), was filed in the U.S. Federal District Court for the District of New Jersey. The complaint alleged that Peterson's sent six advertising faxes to the named plaintiff in 2008-2009 that were not the result of express invitation or permission granted by the plaintiff and did not include certain opt out language. The complaint also alleged that such faxes violated the Federal Telephone Consumer Protection Act (the "TCPA"), purportedly entitling the plaintiff to \$500 per violation, trebled for willful violations for each of the six faxes. The complaint further alleged that Peterson's had sent putative class members more than 10,000 faxes that violated the TCPA, amounting to more than \$5 million in statutory penalty damages and more than \$15 million if trebled for willful violations. The complaint sought to establish a class action. On January 23, 2014, Peterson's and the named plaintiff reached an agreement in principle whereby Peterson's would, without admitting any wrongdoing or liability, settle all claims in the lawsuit, including potential class action claims, for payment of an immaterial amount. The settlement agreement in principle was finalized and received court approval on January 26, 2015.

*Than Zaw v. Nelnet, Inc.*

On January 18, 2013, a Third Amended Complaint was served on Nelnet in connection with a lawsuit by Than Zaw against Nelnet (erroneously referred to in the lawsuit as Nelnet Business Solutions, Inc.) in the Superior Court of the State of California, Contra Costa County. The case was subsequently moved to the U.S. Federal District Court for the Northern District of California. The lawsuit was originally instituted on December 30, 2010, and alleged that Nelnet violated the California Fair Debt Collection Practices Act in its interactions with the plaintiff, a California resident. The plaintiff's Third Amended Complaint added additional allegations claiming that Nelnet violated Section 632 of the California Penal Code by allegedly recording one or more telephone calls to the plaintiff without the plaintiff's consent, and sought \$5,000 in statutory damages per alleged violation. The Third Amended Complaint further alleged that Nelnet improperly recorded telephone calls to other California residents without such persons' consent, and sought to establish a class action with respect to the California Section 632 claim. On October 16, 2013, Nelnet and the named plaintiff reached an agreement in principle whereby Nelnet would, without admitting any wrongdoing or liability, settle all claims in the lawsuit, including potential class action claims, for payment of an immaterial amount. The settlement agreement in principle was finalized and received court approval on November 13, 2014.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
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*Grant Keating v. Peterson's Nelnet, LLC et al*

On August 6, 2012, an Amended Complaint was served on Peterson's, CUnet, LLC ("CUnet"), a subsidiary of Nelnet, and on Nelnet (collectively, the "Keating Defendants"), in connection with a lawsuit by Grant Keating in the U.S. Federal District Court for the Northern District of Ohio (the "Ohio District Court"). The lawsuit was originally instituted on August 24, 2011, and alleges that the Keating Defendants sent an advertising text message to the named plaintiff in June 2011 using an automatic telephone dialing system, and without the plaintiff's express consent. The complaint also alleges that this text message violated the TCPA, purportedly entitling the plaintiff to \$500, trebled for a willful violation. The complaint further alleges that the Keating Defendants sent putative class members similar text messages using an automatic telephone dialing system, without such purported class members' consent. The complaint seeks to establish a class action. On August 29, 2013, the Keating Defendants filed motions for summary judgment, and the named plaintiff filed a motion for class certification. On May 12, 2014, the Ohio District Court granted the Keating Defendants' motion for summary judgment, dismissing the case. On September 8, 2014, the named plaintiff filed an appeal brief with the Circuit Court of Appeals and on October 22, 2014, the Keating Defendants filed a responsive brief. As of the filing date of this report, the Ohio District Court has not established, recognized, or certified a class. The Keating Defendants intend to continue to defend themselves vigorously in this lawsuit.

Due to the uncertainty and risks inherent in class determination and the overall litigation process, the Company believes that a meaningful estimate of a reasonably possible loss, if any, or range of reasonably possible losses, if any, for this lawsuit cannot currently be made.

**Regulatory Matters**

Consumer Financial Protection Bureau Examination

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") established the Consumer Financial Protection Bureau (the "CFPB"), which has broad authority to regulate a wide range of consumer financial products and services. On December 3, 2013, the CFPB issued a rule that allows the CFPB to supervise nonbank student loan servicers that handle more than one million borrowers, including the Company, thus giving the CFPB broad authority to examine, investigate, supervise, and otherwise regulate the Company's businesses, including the authority to impose fines and require changes with respect to any practices that the CFPB finds to be unfair, deceptive, or abusive.

The CFPB is currently conducting its initial supervisory examination of the large nonbank student loan servicers, including the Company. If the CFPB were to determine the Company was not in compliance, it is possible that this could result in material adverse consequences, including, without limitation, settlements, fines, penalties, adverse regulatory actions, changes in the Company's practices, or other actions. However, the Company is unable to estimate at this time any potential financial or other impact that could result from the CFPB's examination, in the event that any adverse regulatory actions occur.

**17. Operating Leases**

The Company is committed under noncancelable operating leases for office space and equipment. Total rental expense incurred by the Company for the years ended December 31, 2014, 2013, and 2012 was \$8.8 million, \$8.1 million, and \$8.1 million, respectively. Minimum future rentals, as of December 31, 2014, under noncancelable operating leases are shown below:

2015	\$	4,468
2016		4,106
2017		3,127
2018		2,669
2019		2,404
2020 and thereafter		6,273
	\$	<u>23,047</u>



**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

**18. Defined Contribution Benefit Plan**

The Company has a 401(k) savings plan that covers substantially all of its employees. Employees may contribute up to 100 percent of their pre-tax salary, subject to IRS limitations. The Company matches up to 100 percent on the first 3 percent of contributions and 50 percent on the next 2 percent. The Company made contributions to the plan of \$4.2 million, \$3.8 million, and \$3.6 million during the years ended December 31, 2014, 2013, and 2012, respectively.

**19. Stock Based Compensation Plans*****Restricted Stock Plan***

The following table summarizes restricted stock activity:

	Year ended December 31,		
	2014	2013	2012
Non-vested shares at beginning of year	407,051	378,671	285,718
Granted	189,716	131,933	168,833
Vested	(77,219)	(62,491)	(41,089)
Canceled	(20,085)	(41,062)	(34,791)
Non-vested shares at end of year	499,463	407,051	378,671

As of December 31, 2014, there was \$9.0 million of unrecognized compensation cost included in "additional paid-in capital" on the consolidated balance sheet related to restricted stock, which is expected to be recognized as compensation expense as shown in the table below.

2015	\$	3,694
2016		2,174
2017		1,261
2018		736
2019		439
2020 and thereafter		694
	\$	8,998

For the years ended December 31, 2014, 2013, and 2012, the Company recognized compensation expense of \$4.6 million, \$3.1 million, and \$2.2 million, respectively, related to shares issued under the restricted stock plan, which is included in "salaries and benefits" on the consolidated statements of income.

***Employee Share Purchase Plan***

The Company has an employee share purchase plan pursuant to which employees are entitled to purchase Class A common stock from payroll deductions at a 15 percent discount from market value. During the years ended December 31, 2014, 2013, and 2012, the Company recognized compensation expense of approximately \$131,000, \$148,000, and \$114,000, respectively, in connection with issuing 18,140 shares, 18,004 shares, and 21,766 shares, respectively, under this plan.

***Non-employee Directors Compensation Plan***

The Company has a compensation plan for non-employee directors pursuant to which non-employee directors can elect to receive their annual retainer fees in the form of cash or Class A common stock. If a nonemployee director elects to receive Class A common stock, the number of shares of Class A common stock that are awarded is equal to the amount of the annual retainer fee otherwise payable in cash divided by 85 percent of the fair market value of a share of Class A common stock on the date the fee is payable. Non-employee directors who choose to receive Class A common stock may also elect to defer receipt of the Class A common stock until termination of their service on the board of directors.

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

For the years ended December 31, 2014 , 2013 , and 2012 , the Company recognized approximately \$777,000 , \$673,000 , and \$688,000 , respectively, of expense related to this plan. The following table provides the number of shares awarded under this plan for the years ended December 31, 2014 , 2013 , and 2012 .

	Shares issued - not deferred	Shares- deferred	Total
Year ended December 31, 2014	8,067	10,175	18,242
Year ended December 31, 2013	10,156	5,279	15,435
Year ended December 31, 2012	16,561	16,700	33,261

As of December 31, 2014 , a cumulative amount of 136,495 shares have been deferred by directors and will be issued upon the termination of their service on the board of directors. These shares are included in the Company's weighted average shares outstanding calculation.

**20. Related Parties*****Transactions with Union Financial Services***

Union Financial Services, Inc. ("UFS") is owned 50 percent by Michael S. Dunlap, Executive Chairman and a member of the board of directors and a significant shareholder of the Company, and 50 percent by Stephen F. Butterfield, Vice Chairman and a member of the board of directors of the Company. During 2013, the Company purchased an aircraft for total consideration of \$5.8 million and sold an interest in such aircraft to UFS for \$2.0 million . After the completion of this transaction, the Company and UFS own 65 percent and 35 percent of the aircraft, respectively.

***Transactions with Union Bank and Trust Company***

Union Bank and Trust Company ("Union Bank") is controlled by Farmers & Merchants Investment Inc. ("F&M"), which owns a majority of Union Bank's common stock and a minority share of Union Bank's non-voting preferred stock. Mr. Dunlap, along with his spouse and children, owns or controls a significant portion of the stock of F&M, and Mr. Dunlap's sister, Angela L. Muhleisen, along with her husband and children, also owns or controls a significant portion of F&M stock. Mr. Dunlap serves as a Director and Chairman of F&M. Ms. Muhleisen serves as Director and President of F&M and as a Director, Chairperson, President, and Chief Executive Officer of Union Bank. Union Bank is deemed to have beneficial ownership of a significant number of shares of the Company because it serves in a capacity of trustee or account manager for various trusts and accounts holding shares of the Company, and may share voting and/or investment power with respect to such shares. Mr. Dunlap and Ms. Muhleisen beneficially own a significant percent of the voting rights of the Company's outstanding common stock.

The Company has entered into certain contractual arrangements with Union Bank. These transactions are summarized below.

**Loan Purchases and Sales**

During the years ended December 31, 2014 , 2013 , and 2012 , the Company purchased FFELP student loans from Union Bank of \$0.2 million (par value), \$478.4 million (par value), and \$0.3 million (par value), respectively. Loans purchased during 2013 were purchased at a discount of \$11.4 million . No discount or premium was paid for loans purchased during 2014 and 2012 .

During 2014, the Company sold \$16.5 million (par value) of private education loans to Union Bank. No discount or premium was received.

On December 22, 2014, the Company entered into an agreement with Union Bank in which the Company will provide marketing, origination, and loan servicing services to Union Bank related to private education loans. The Company has committed to purchase, or arrange for a designee to purchase, all volume originated by Union Bank under this agreement. No loans were originated under this agreement in 2014.

**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

Loan Servicing

The Company serviced \$581.4 million , \$598.9 million , and \$445.8 million of FFELP and private education loans for Union Bank as of December 31, 2014 , 2013 , and 2012 , respectively. Servicing revenue earned by the Company from servicing loans for Union Bank was \$0.4 million , \$1.3 million , and \$1.7 million for the years ended December 31, 2014 , 2013 , and 2012 , respectively. In September 2013, the servicing agreement between the Company and Union Bank was amended to change the calculation of servicing fees paid by Union Bank, which led to a decrease in the servicing revenue earned by the Company from Union Bank in 2014 compared to 2013. As of December 31, 2014 and 2013 , accounts receivable includes approximately \$36,000 and \$40,000 , respectively, due from Union Bank for loan servicing.

Funding - Participation Agreement

The Company maintains an agreement with Union Bank, as trustee for various grantor trusts, under which Union Bank has agreed to purchase from the Company participation interests in student loans (the “FFELP Participation Agreement”). The Company uses this facility as a source to fund FFELP student loans. As of December 31, 2014 and 2013 , \$543.0 million and \$342.5 million , respectively, of loans were subject to outstanding participation interests held by Union Bank, as trustee, under this agreement. The agreement automatically renews annually and is terminable by either party upon five business days notice. This agreement provides beneficiaries of Union Bank's grantor trusts with access to investments in interests in student loans, while providing liquidity to the Company on a short-term basis. The Company can participate loans to Union Bank to the extent of availability under the grantor trusts, up to \$750 million or an amount in excess of \$750 million if mutually agreed to by both parties. Loans participated under this agreement have been accounted for by the Company as loan sales. Accordingly, the participation interests sold are not included on the Company's consolidated balance sheets.

Subparticipation Agreement

On January 1, 2014, the Company subparticipated the Company's participation interest in a loan receivable from an unrelated third party to Union Bank. As of December 31, 2014 , the participated portion of the loan was \$2.6 million , with an obligation to fund an additional \$0.5 million . As part of this agreement, Union Bank will pay the Company monthly servicing fees equal to 40 basis points on the participated portion of the outstanding principal balance of the loan.

Operating Cash Accounts

The majority of the Company's cash operating accounts are maintained at Union Bank. The Company also invests amounts in the Short term Federal Investment Trust (“STFIT”) of the Student Loan Trust Division of Union Bank, which are included in “cash and cash equivalents - held at a related party” and “restricted cash - due to customers” on the accompanying consolidated balance sheets. As of December 31, 2014 and 2013 , the Company had \$107.6 million and \$81.0 million , respectively, invested in the STFIT or deposited at Union Bank in operating accounts, of which \$14.9 million and \$26.3 million as of December 31, 2014 and 2013 , respectively, represented cash collected for customers. Interest income earned by the Company on the amounts invested in the STFIT for the years ended December 31, 2014 , 2013 , and 2012 , was \$0.2 million , \$0.1 million , and \$0.2 million , respectively.

529 Plan Administration Services

The Company provides certain 529 Plan administration services to certain college savings plans (the “College Savings Plans”) through a contract with Union Bank, as the program manager. Union Bank is entitled to a fee as program manager pursuant to its program management agreement with the College Savings Plans. For the years ended December 31, 2014 , 2013 , and 2012 , the Company has received fees of \$3.4 million , \$2.8 million , and \$1.7 million , respectively, from Union Bank related to the administration services provided to the College Savings Plans.

Lease Arrangements

Union Bank leases approximately 4,000 square feet in the Company's corporate headquarters building. Union Bank paid the Company approximately \$76,000 , \$72,000 , and \$74,000 for commercial rent and storage income during 2014 , 2013 , and 2012 , respectively. The lease agreement expires on June 30, 2018.

## NELNET, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The Company had a lease agreement with Union Bank under which the Company leased office space. The Company paid Union Bank approximately \$71,000 , \$159,000 , and \$43,000 during 2014 , 2013 , and 2012 , respectively. The lease agreement expired in May 2014.

#### Other Fees Paid to Union Bank

During the years ended December 31, 2014 , 2013 , and 2012 , the Company paid Union Bank approximately \$57,000 , \$107,000 , and \$92,000 , respectively, in commissions; approximately \$117,000 , \$140,000 , and \$187,000 , respectively, in cash management fees, and approximately \$311,000 , \$52,000 , and \$0 , respectively, in connection with servicing opportunities for various asset classes. In addition, the Company pays Union Bank \$36,000 each year for administrative services.

#### Other Fees Received from Union Bank

During the years ended December 31, 2014 , 2013 , and 2012 , Union Bank paid the Company approximately \$178,000 , \$170,000 , and \$152,000 , respectively, under an employee sharing arrangement and approximately \$14,000 , \$18,000 , and \$31,000 , respectively, for health and productivity services.

#### 401(k) Plan Administration

Union Bank administers the Company's 401(k) defined contribution plan. Fees paid to Union Bank to administer the plan are paid by the plan participants and were approximately \$450,000 , \$370,000 , and \$305,000 during the years ended December 31, 2014 , 2013 , and 2012 , respectively.

#### Investment Services

Union Bank has established various trusts whereby Union Bank serves as trustee for the purpose of purchasing, holding, managing, and selling investments in student loan asset-backed securities. On May 9, 2011, WRCM, an SEC-registered investment advisor and a subsidiary of the Company, entered into a management agreement with Union Bank, effective as of May 1, 2011, under which WRCM performs various advisory and management services on behalf of Union Bank with respect to investments in securities by the trusts, including identifying securities for purchase or sale by the trusts. The agreement provides that Union Bank will pay to WRCM annual fees of 25 basis points on the outstanding balance of the investments in the trusts. As of December 31, 2014 , the outstanding balance of investments in the trusts was \$536.0 million . In addition, Union Bank will pay additional fees to WRCM of up to 50 percent of the gains from the sale of securities from the trusts. For the years ended December 31, 2014 , 2013 , and 2012 , the Company earned \$13.4 million , \$12.9 million , and \$8.4 million , respectively, of fees under this agreement.

On January 20, 2012, WRCM entered into a management agreement with Union Bank under which it was designated to serve as investment advisor with respect to the assets within several trusts established by Mr. Dunlap. Union Bank serves as trustee for the trusts. Per the terms of this agreement, Union Bank pays WRCM five basis points of the aggregate value of the assets of the trusts as of the last day of each calendar quarter. Mr. Dunlap contributed a total of 3,375,000 shares of the Company's Class B common stock to the trusts upon the establishment thereof. For the years ended December 31, 2014 , 2013 , and 2012 , the Company earned approximately \$66,000 , \$61,000 , and \$44,000 , respectively, of fees under this agreement.

As of December 31, 2014 and 2013 , accounts receivable included \$1.7 million and \$3.3 million , respectively, due from Union Bank related to fees earned by WRCM from the investment services described above.

WRCM has established five private investment funds for the primary purpose of purchasing, selling, investing, and trading, directly or indirectly, in student loan asset-backed securities, and to engage in financial transactions related thereto. Mr. Dunlap, UFS, Jeffrey R. Noordhoek (an executive officer of the Company), F&M, Ms. Muhleisen and her spouse, and WRCM have invested in certain of these funds. Based upon the current level of holdings by non-affiliated limited partners, the management agreements provide non-affiliated limited partners the ability to remove WRCM as manager without cause. WRCM earns 50 basis points (annually) on the outstanding balance of the investments in these funds, of which WRCM pays approximately 50 percent of such amount to Union Bank as custodian. As of December 31, 2014 , the outstanding balance of investments in these five funds was \$144.9 million . For the years ended December 31, 2014 , 2013 , and 2012 , the Company paid Union Bank \$0.3 million , \$0.3 million , and \$0.1 million , respectively, as custodian.

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

**21. Fair Value**

The following tables present the Company's financial assets and liabilities that are measured at fair value on a recurring basis. There were no transfers into or out of level 1, level 2, or level 3 for the year ended December 31, 2014 .

	As of December 31, 2014			As of December 31, 2013		
	Level 1	Level 2	Total	Level 1	Level 2	Total
<b>Assets:</b>						
Investments: (a)						
Student loan asset-backed securities	\$ —	145,000	145,000	—	188,279	188,279
Equity securities	3,736	—	3,736	3,282	—	3,282
Debt securities	387	—	387	479	—	479
Total investments	4,123	145,000	149,123	3,761	188,279	192,040
Fair value of derivative instruments (b)	—	64,392	64,392	—	62,507	62,507
Total assets	\$ 4,123	209,392	213,515	3,761	250,786	254,547
<b>Liabilities:</b>						
Fair value of derivative instruments (b):	\$ —	32,842	32,842	—	17,969	17,969
Total liabilities	\$ —	32,842	32,842	—	17,969	17,969

(a) Investments represent investments recorded at fair value on a recurring basis. Level 1 investments are measured based upon quoted prices and include investments traded on an active exchange, such as the New York Stock Exchange, and corporate bonds, mortgage-backed securities, U.S. government bonds, and U.S. Treasury securities that trade in active markets. Level 2 investments include student loan asset-backed securities. The fair value for the student loan asset-backed securities is determined using indicative quotes from broker-dealers or an income approach valuation technique (present value using the discount rate adjustment technique) that considers, among other things, rates currently observed in publicly traded debt markets for debt of similar terms issued by companies with comparable credit risk.

(b) All derivatives are accounted for at fair value on a recurring basis. The fair value of derivative financial instruments is determined using a market approach in which derivative pricing models use the stated terms of the contracts and observable yield curves, forward foreign currency exchange rates, and volatilities from active markets.

When determining the fair value of derivatives, the Company takes into account counterparty credit risk for positions where it is exposed to the counterparty on a net basis by assessing exposure net of collateral held. The net exposures for each counterparty are adjusted based on market information available for the specific counterparty.

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

The following table summarizes the fair values of all of the Company's financial instruments on the consolidated balance sheets:

<b>As of December 31, 2014</b>					
	<b>Fair value</b>	<b>Carrying value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Financial assets:</b>					
Student loans receivable	\$ 28,954,266	28,005,195	—	—	28,954,266
Cash and cash equivalents	130,481	130,481	130,481	—	—
Investments	149,123	149,123	4,123	145,000	—
Restricted cash	800,164	800,164	800,164	—	—
Restricted cash – due to customers	118,488	118,488	118,488	—	—
Restricted investments	50,276	50,276	50,276	—	—
Accrued interest receivable	351,588	351,588	—	351,588	—
Derivative instruments	64,392	64,392	—	64,392	—
<b>Financial liabilities:</b>					
Bonds and notes payable	27,809,997	28,027,350	—	27,809,997	—
Accrued interest payable	25,904	25,904	—	25,904	—
Due to customers	118,488	118,488	118,488	—	—
Derivative instruments	32,842	32,842	—	32,842	—

<b>As of December 31, 2013</b>					
	<b>Fair value</b>	<b>Carrying value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Financial assets:</b>					
Student loans receivable	\$ 26,641,383	25,907,589	—	—	26,641,383
Cash and cash equivalents	63,267	63,267	63,267	—	—
Investments	192,040	192,040	3,761	188,279	—
Restricted cash	727,838	727,838	727,838	—	—
Restricted cash – due to customers	167,576	167,576	167,576	—	—
Restricted investments	7,285	7,285	7,285	—	—
Accrued interest receivable	314,553	314,553	—	314,553	—
Derivative instruments	62,507	62,507	—	62,507	—
<b>Financial liabilities:</b>					
Bonds and notes payable	25,577,250	25,955,289	—	25,577,250	—
Accrued interest payable	21,725	21,725	—	21,725	—
Due to customers	167,576	167,576	167,576	—	—
Derivative instruments	17,969	17,969	—	17,969	—

The methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value on a recurring basis are previously discussed. The remaining financial assets and liabilities were estimated using the following methods and assumptions:

***Student Loans Receivable***

If the Company has the ability and intent to hold loans for the foreseeable future, such loans are held for investment and carried at amortized cost. Fair values for student loan receivables were determined by modeling loan cash flows using stated terms of the assets and internally-developed assumptions to determine aggregate portfolio yield, net present value, and average life. The significant assumptions used to project cash flows are prepayment speeds, default rates, cost of funds, required return on equity, and future interest rate and index relationships. A number of significant inputs into the models are internally derived and not observable to market participants.

***Cash and Cash Equivalents, Restricted Cash, Restricted Cash – Due to Customers, Restricted Investments, Accrued Interest Receivable/Payable and Due to Customers***

The carrying amount approximates fair value due to the variable rate of interest and/or the short maturities of these instruments.

# NELNET, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

### Bonds and Notes Payable

Bonds and notes payable are accounted for at cost in the financial statements except when denominated in a foreign currency. Foreign currency-denominated borrowings are re-measured at current spot rates in the financial statements. The fair value of bonds and notes payable was determined from quotes from broker-dealers or through standard bond pricing models using the stated terms of the borrowings, observable yield curves, and market credit spreads. Fair value adjustments for unsecured corporate debt are made based on indicative quotes from observable trades.

### Limitations

The fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Therefore, the calculated fair value estimates in many instances cannot be substantiated by comparison to independent markets and, in many cases, may not be realizable in a current sale of the instrument. Changes in assumptions could significantly affect the estimates.

### 22. Quarterly Financial Information (Unaudited)

	2014			
	First quarter	Second quarter	Third quarter	Fourth quarter
Net interest income	\$ 98,871	107,713	117,487	112,492
Less provision for loan losses	2,500	1,500	2,000	3,500
Net interest income after provision for loan losses	96,371	106,213	115,487	108,992
Loan and guaranty servicing revenue	64,757	66,460	52,659	56,538
Tuition payment processing and campus commerce revenue	25,235	21,834	26,399	24,688
Enrollment services revenue	22,011	20,145	22,936	17,791
Other income	18,131	15,315	7,650	12,906
Gain on sale of loans and debt repurchases, net	39	18	—	3,594
Derivative market value and foreign currency adjustments and derivative settlements, net	(4,265)	1,570	24,203	(5,648)
Salaries and benefits	(52,484)	(53,888)	(61,098)	(60,609)
Cost to provide enrollment services	(14,475)	(13,311)	(14,178)	(11,343)
Depreciation and amortization	(4,783)	(5,214)	(5,493)	(5,644)
Operating expenses - other	(35,627)	(40,377)	(36,676)	(37,310)
Income tax expense	(40,611)	(43,078)	(46,513)	(30,036)
Net income	74,299	75,687	85,376	73,919
Net income attributable to noncontrolling interest	513	693	157	308
Net income attributable to Nelnet, Inc.	\$ 73,786	74,994	85,219	73,611
Earnings per common share:				
Net income attributable to Nelnet, Inc. shareholders - basic and diluted	\$ 1.59	1.61	1.84	1.59

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**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

	<b>2013</b>			
	<b>First quarter</b>	<b>Second quarter</b>	<b>Third quarter</b>	<b>Fourth quarter</b>
Net interest income	\$ 98,798	101,419	104,922	108,736
Less provision for loan losses	5,000	5,000	5,000	3,500
Net interest income after provision for loan losses	93,798	96,419	99,922	105,236
Loan and guaranty servicing revenue	55,601	60,078	64,582	63,167
Tuition payment processing and campus commerce revenue	23,411	18,356	19,927	18,988
Enrollment services revenue	28,957	24,823	22,563	21,735
Other income	9,416	12,288	8,613	15,981
Gain on sale of loans and debt repurchases, net	1,407	7,355	2,138	799
Derivative market value and foreign currency adjustments and derivative settlements, net	1,072	40,188	(16,648)	(5,655)
Salaries and benefits	(47,905)	(47,432)	(48,712)	(52,120)
Cost to provide enrollment services	(19,642)	(16,787)	(14,668)	(13,864)
Depreciation and amortization	(4,377)	(4,320)	(4,340)	(5,274)
Operating expenses - other	(34,941)	(34,365)	(39,887)	(40,349)
Income tax expense	(38,447)	(54,746)	(30,444)	(37,556)
Net income	68,350	101,857	63,046	71,088
Net income attributable to noncontrolling interest	271	614	216	568
Net income attributable to Nelnet, Inc.	\$ 68,079	101,243	62,830	70,520
Earnings per common share:				
Net income attributable to Nelnet, Inc. shareholders - basic and diluted	\$ 1.46	2.17	1.35	1.52

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# NELNET, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (continued)

(Dollars in thousands, except share amounts, unless otherwise noted)

## 23. Condensed Parent Company Financial Statements

The following represents the condensed balance sheets as of December 31, 2014 and 2013 and condensed statements of income, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2014 for Nelnet, Inc.

The Company is limited in the amount of funds that can be transferred to it by its subsidiaries through intercompany loans, advances, or cash dividends. These limitations relate to the restrictions by trust indentures under the education lending subsidiaries debt financing arrangements. The amounts of cash and investments restricted in the respective reserve accounts of the education lending subsidiaries are shown on the consolidated balance sheets as restricted cash and investments.

### Balance Sheets

(Parent Company Only)

As of December 31, 2014 and 2013

	2014	2013
<b>Assets:</b>		
Cash and cash equivalents	\$ 30,712	24,032
Investments	136,432	175,887
Investment in subsidiary debt	122,057	233,095
Restricted cash	127	3,763
Investment in subsidiaries	1,300,032	957,676
Other assets	283,831	272,910
Fair value of derivative instruments	64,392	25,673
<b>Total assets</b>	<b>\$ 1,937,583</b>	<b>1,693,036</b>
<b>Liabilities:</b>		
Notes payable	\$ 149,265	191,457
Other liabilities	50,253	39,620
Fair value of derivative instruments	12,387	17,969
<b>Total liabilities</b>	<b>211,905</b>	<b>249,046</b>
<b>Equity:</b>		
Nelnet, Inc. shareholders' equity:		
Common stock	463	464
Additional paid-in capital	17,290	24,887
Retained earnings	1,702,560	1,413,492
Accumulated other comprehensive earnings	5,135	4,819
<b>Total Nelnet, Inc. shareholders' equity</b>	<b>1,725,448</b>	<b>1,443,662</b>
Noncontrolling interest	230	328
<b>Total equity</b>	<b>1,725,678</b>	<b>1,443,990</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,937,583</b>	<b>1,693,036</b>

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**NELNET, INC. AND SUBSIDIARIES**  
Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

**Statements of Income**  
(Parent Company Only)  
Years ended December 31, 2014, 2013, and 2012

	2014	2013	2012
Investment interest	\$ 6,863	7,911	5,186
Interest on bonds and notes payable	5,492	4,433	3,607
Net interest income	1,371	3,478	1,579
Other income (expense):			
Other income	8,943	7,112	8,010
Gain from debt repurchases	6,685	11,905	4,487
Equity in subsidiaries income	316,934	275,989	224,011
Derivative market value adjustments and derivative settlements, net	14,963	28,134	(47,262)
Total other income	347,525	323,140	189,246
Operating expenses	5,598	5,626	1,867
Income before income taxes	343,298	320,992	188,958
Income tax expense	(34,017)	(16,651)	(10,530)
Net income	309,281	304,341	178,428
Net income attributable to noncontrolling interest	1,671	1,669	431
Net income attributable to Nelnet, Inc.	\$ 307,610	302,672	177,997

**Statements of Comprehensive Income**  
(Parent Company Only)  
Years ended December 31, 2014, 2013, and 2012

	2014	2013	2012
Net income	\$ 309,281	304,341	178,428
Other comprehensive income:			
Available-for-sale securities:			
Unrealized holding gains arising during period, net	9,006	9,134	10,230
Less reclassification adjustment for gains recognized in net income, net of losses	(8,506)	(5,938)	(5,798)
Income tax effect	(184)	(1,190)	(1,619)
Total other comprehensive income	316	2,006	2,813
Comprehensive income	309,597	306,347	181,241
Comprehensive income attributable to noncontrolling interest	1,671	1,669	431
Comprehensive income attributable to Nelnet, Inc.	\$ 307,926	304,678	180,810

**NELNET, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements – (continued)  
(Dollars in thousands, except share amounts, unless otherwise noted)

**Statements of Cash Flows**

(Parent Company Only)

Years ended December 31, 2014, 2013, and 2012

	<b>2014</b>	<b>2013</b>	<b>2012</b>
Net income attributable to Nelnet, Inc.	\$ 307,610	302,672	177,997
Net income attributable to noncontrolling interest	1,671	1,669	431
Net income	309,281	304,341	178,428
Adjustments to reconcile net income to net cash (used by) provided by operating activities:			
Depreciation and amortization	303	284	249
Derivative market value adjustment	(36,979)	(57,525)	30,041
Proceeds (payments) to terminate and/or amend derivative instruments, net	1,765	(6,469)	(6,005)
Payment for interest rate swap option	(9,087)	—	—
Equity in earnings of subsidiaries	(316,934)	(275,989)	(224,011)
Gain from sale of available-for-sale securities, net	(8,506)	(5,938)	(5,798)
Gain from debt repurchases	(6,685)	(11,905)	(4,487)
Other non-cash items	5,396	3,835	3,569
Decrease in other assets	4,057	209,896	168,656
Increase (decrease) in other liabilities	12,512	16,205	(38,971)
Net cash (used by) provided by operating activities	(44,877)	176,735	101,671
Cash flows from investing activities:			
Decrease (increase) in restricted cash	3,636	59,495	(29,082)
Purchases of available-for-sale securities	(192,315)	(217,415)	(186,727)
Proceeds from sales of available-for-sale securities	240,371	116,337	162,533
Capital contributions to/from subsidiaries, net	(25,017)	—	—
Sales (purchases) of subsidiary debt, net	111,038	(66,272)	(6,584)
Purchases of other investments, net	(14,769)	(11,758)	—
Net cash provided by (used in) investing activities	122,944	(119,613)	(59,860)
Cash flows from financing activities:			
Payments on notes payable	(63,084)	(147,080)	(109,748)
Proceeds from issuance of notes payable	27,577	135,000	153,380
Payments of debt issuance costs	(512)	(644)	(1,111)
Dividends paid	(18,542)	(18,569)	(66,237)
Repurchases of common stock	(15,713)	(13,136)	(22,763)
Proceeds from issuance of common stock	656	561	480
Payments received on employee stock notes receivable	—	—	1,140
Issuance of noncontrolling interest	201	5	5
Distribution to noncontrolling interest	(1,970)	(1,351)	(431)
Net cash used in financing activities	(71,387)	(45,214)	(45,285)
Net increase (decrease) in cash and cash equivalents	6,680	11,908	(3,474)
Cash and cash equivalents, beginning of period	24,032	12,124	15,598
Cash and cash equivalents, end of period	\$ 30,712	24,032	12,124

## **RESOLUTION 15 -**

### **BE IT RESOLVED BY THE MAYOR AND CITY COUNCIL OF THE CITY OF SCOTTSBLUFF, NEBRASKA:**

- a. On January 19, 2010, the City of Scottsbluff granted a franchise (the “Franchise”), pursuant to Article 5 or Chapter 11 of the Municipal Code (the “Code”), for a Cable System to Allo Twin Cities, LLC (the “Franchisee”). Capitalized terms not otherwise defined in this Resolution shall have the same meaning as provided for in the Franchise Agreement.
- b. The Franchisee is a wholly owned subsidiary of Allo Communications, LLC (“Allo”). Allo has entered into an agreement with Nelnet, Inc. (“Nelnet”) which will provide for Nelnet acquiring 92.5% of the ownership interests of Allo (the “Transaction”). The remaining ownership interests will be held by the current management and owners of Allo.
- c. The result of the acquisition by Nelnet will mean an indirect change in control of the Franchisee and the Franchisee has requested the City’s consent pursuant to Section 38 of the Cable Ordinance.
- d. The Franchisee has submitted information concerning the acquisition by Nelnet, to include financial information for Nelnet, which information has been reviewed by the City.

#### **Resolved by the Mayor and City Council of the City that:**

1. Pursuant to Section 11-5-38 of the Code, the Council has considered the information submitted to it by Allo and Nelnet, along with the following:
  - a. the qualifications of Nelnet, to include the financial ability and stability of Nelnet.
  - b. the experience of Nelnet and Allo.
  - c. the legal integrity of the Franchisee, Allo and Nelnet, and the connection between the Franchisee, Allo and Nelnet.
  - d. the economic viability of the Cable System in the future.
2. Based on the consideration of the above factors, the City consents to the Transaction.
2. The Franchisee shall continue to be bound by all of the obligations and liabilities of the Franchise and the Cable Ordinance.
3. This Resolution shall be considered effective as of this date.

Passed and approved on December 21, 2015.

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Mayor

ATTEST:

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Cindy Dickinson, City Clerk