# NORTHSTAR EDUCATION FINANCE, INC. AND SUBSIDIARIES

Eagan, Minnesota

FINANCIAL STATEMENTS

Including Independent Auditors' Report

As of and for the Years Ended September 30, 2014 and 2013

## Northstar Education Finance, Inc. and Subsidiaries

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# INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Northstar Education Finance, Inc.
Eagan, Minnesota

We have audited the accompanying consolidated financial statements of Northstar Education Finance, Inc. and its subsidiaries, which comprise the consolidated statements of financial position as of September 30, 2014 and 2013, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

## *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northstar Education Finance, Inc. and its subsidiaries as of September 30, 2014 and 2013 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Minneapolis, Minnesota
December 10, 2014

## Northstar Education Finance, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As of September 30, 2014 and 2013
(in thousands)

### *ASSETS*

| | 2014 | 2013 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents (Note 2) | $ 7,391 | $ 9,688 |
| Loans, net (Note 2, 3, and 4) | 3,643,951 | 3,961,722 |
| Interest receivable | 49,587 | 64,003 |
| Servicer receivable (Note 2) | 11,106 | 9,936 |
| Restricted cash and cash equivalents (Note 2) | 120,792 | 123,505 |
| Debt issuance costs, net (Note 2) | 11,530 | 13,954 |
| Prepaid expenses | 68 | 67 |
| **TOTAL ASSETS** | $ 3,844,425 | $ 4,182,875 |

### *LIABILITIES AND NET ASSETS*

| | 2014 | 2013 |
|---|---|---|
| **LIABILITIES** | | |
| Accounts payable and accrued liabilities | $ 7,940 | $ 9,947 |
| Government payable (Note 2) | 9,715 | 10,768 |
| Long-term debt (Note 6) | 3,601,673 | 3,962,024 |
| Total Liabilities | 3,619,328 | 3,982,739 |
| **NET ASSETS** | | |
| Net assets - unrestricted | 225,097 | 200,136 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ 3,844,425 | $ 4,182,875 |

See accompanying notes to consolidated financial statements.

## Northstar Education Finance, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF ACTIVITIES
For the Years Ended September 30, 2014 and 2013
(in thousands)

| | 2014 | 2013 |
|---|---|---|
| **OPERATING REVENUE** | | |
| Student loan interest income (Note 2) | $ 99,373 | $ 108,273 |
| **OPERATING EXPENSES** | | |
| Interest expense | 28,813 | 31,822 |
| Financing expense | 2,290 | 4,179 |
| Loan servicing fees | 18,987 | 20,465 |
| Loan consolidation fees | 26,169 | 27,800 |
| T.H.E. bonus expense | - | 3,420 |
| Provision for loan losses (Note 4) | (5,757) | 4,797 |
| Federal loan default expense | 471 | 549 |
| Amortization of debt issuance costs | 2,424 | 1,184 |
| Professional services | 416 | 519 |
| Grants and other donations | 800 | 495 |
| Other | 140 | 140 |
| Total Operating Expenses | 74,753 | 95,370 |
| **OTHER INCOME (EXPENSE)** | | |
| Gain on sale of investment in subsidiary (Note 5) | - | 3,987 |
| Sub-servicing fees | 232 | 264 |
| Interest income | 109 | 111 |
| Other expenses | - | (16) |
| Total Other Income | 341 | 4,346 |
| **CHANGE IN NET ASSETS** | 24,961 | 17,249 |
| **NET ASSETS, BEGINNING OF PERIOD** | 200,136 | 182,887 |
| **NET ASSETS, END OF PERIOD** | $ 225,097 | $ 200,136 |

See accompanying notes to consolidated financial statements.

## Northstar Education Finance, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Change in net assets | $ 24,961 | $ 17,249 |
| Adjustments to reconcile change in net assets to cash flows from operating activities | | |
| Amortization of debt issuance costs | 2,424 | 1,184 |
| Provision for loan losses | (5,757) | 4,797 |
| Loan premium amortization | 10,029 | 10,783 |
| Gain on sale from investment in subsidiary | - | (3,987) |
| (Increase) decrease in assets | | |
| Interest receivable | 14,416 | 17,383 |
| Servicer receivable | (1,170) | (735) |
| Prepaid expenses | (1) | (11) |
| Decrease in liabilities | | |
| Accounts payable and accrued liabilities | (2,007) | (1,723) |
| Government payable | (1,053) | (1,094) |
| Net Cash Flows From Operating Activities | 41,842 | 43,846 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from payments on student loans | 313,499 | 310,159 |
| Proceeds from sale of investment in subsidiary | - | 2,751 |
| Payments to prior shareholders of amounts held in escrow | - | (1,172) |
| Net change in restricted cash | 2,713 | 4,002 |
| Net Cash Flows From Investing Activities | 316,212 | 315,740 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Payments on draw against bank lines of credit | - | (808,000) |
| Payments on long-term debt | (360,351) | (340,554) |
| Proceeds from issuance of long-term debt | - | 785,300 |
| Payments for debt issuance costs | - | (5,231) |
| Net Cash Flows From Financing Activities | (360,351) | (368,485) |
| **Net Decrease in Cash and Cash Equivalents** | (2,297) | (8,899) |
| **CASH AND CASH EQUIVALENTS - Beginning of Year** | 9,688 | 18,587 |
| **CASH AND CASH EQUIVALENTS - End of Year** | $ 7,391 | $ 9,688 |
| **CASH PAID FOR INTEREST** | $ 28,799 | $ 34,066 |

See accompanying notes to consolidated financial statements.

## NOTE 1 - Business Operations

Northstar Education Finance, Inc. ("NEF" or the "Company") is a Delaware non-stock nonprofit corporation that was incorporated in January 2000 and was formed to administer the student loan programs started by NorthStar Guarantee, Inc. Shortly after receiving a favorable determination from the Internal Revenue Service in March of 2003 that NEF was an organization described in Section 501 (c) (3) of the Internal Revenue Code, NorthStar Guarantee, Inc. transferred beneficial ownership of all remaining assets (including all student loans) to NEF, and NEF assumed all associated liabilities. Effective July 1, 2010, federal legislation eliminated the authority to provide new loans under The Federal Family Education Loan Program ("FFELP") and required that all new federal loans be made through the Direct Student Loan Program ("DSLP"). Because of this and disruptions in the credit markets, the Company is no longer in the business of originating federal or private student loans, but continues to manage its historic loan portfolio.

The Company is dedicated to helping students obtain an affordable education and it continues to support its charitable purpose, which is to foster, aid, encourage and assist the pursuit of higher education. Supporting its mission, the Company provides students who have existing loans which were issued under NEF's T.H.E. Loan Program, the lowest possible cost on their loans. In particular, the Company returns excess revenues to student borrowers in the form of the 'T.H.E. Bonus' program. NEF's primary charitable goals are to (a) continue servicing its outstanding student loans; (b) continue to provide education and assistance to student borrowers to enable them to successfully repay their loans; (c) manage its financings as necessary to maximize the T.H.E. Bonus paid to student borrowers; and (d) make grants to other organizations in furtherance of its educational mission.

The Company has financed its student loan portfolio through a series of student loan asset-backed note issues, beginning with the first issue in the year 2000. As a result, most of the Company's student loans have been pledged under indentures and are held by trusts specific to the respective securities issues.

NEF's Board of Directors provides oversight to the Company, but as NEF has no employees, management and administrative operations are performed by a third party pursuant to a Master Services Agreement ('MSA') between NEF and Northstar Capital Market Services, Inc. ('NCMS') and a Sub-servicing Agreement between NCMS and Northstar Education Services, LLC ('NES'), a wholly-owned subsidiary of Great Lakes Education Loan Servicing, Inc. See Master Servicing below.

All T.H.E Loan Program loans, related financial assets and associated liabilities are assets or liabilities of NEF, either directly or through its wholly-owned limited liability company subsidiary, Northstar Education Funding, I, LLC. Any potential claims against or liabilities of the subsidiary would be payable only out of the assets of that subsidiary.

## NOTE 1 - Business Operations (cont.)

*Master Servicing*

Shortly after its incorporation in January 2000, NEF formed Northstar Capital Market Services, Inc. ("NCMS"), a Delaware for-profit organization, to administer the T.H.E. Loan Program and provide services to other third-parties involved in educational services. NEF owned 56% of NCMS's issued and outstanding capital stock and nine members of NCMS's management collectively owned 42%. The remaining 2% of outstanding stock was owned by a charitable foundation. On August 30, 2010, the Company increased its investment in NCMS by purchasing an additional 2% interest and simultaneously sold all of its then interests in NCMS to an unrelated party, liquidating all of the Company's investment and control in the subsidiary. Simultaneously, NCMS entered into a Master Servicing Agreement ("MSA") with NEF to provide services which include administrative and support for all of NEF's student loans and related programs, management of NEF's obligations under financing agreements, accounting, reporting and cash management for NEF, and other services as set forth in the MSA. The MSA will expire in August 2017.

On October 1, 2012, NCMS entered into an Asset Purchase Agreement (or "APA") with NES, a wholly-owned subsidiary of Great Lakes Education Loan Servicing, Inc. Pursuant to the APA, NCMS retains its master servicing business, including but not limited to the rights and obligations of NCMS under the MSA. In conjunction with the APA, all of the employees of NCMS became employees of NES. NCMS and NES entered into a Subservicing Agreement dated October 1, 2012 (the "Initial Subservicing Agreement") to provide that NES shall, under NCMS's supervision and direction, perform certain of NCMS's responsibilities with respect to its master servicing business, including the responsibilities under the MSA. These responsibilities are all being performed by the former NCMS employees that became employees of NES. On October 25, 2012, the Initial Subservicing Agreement was amended and restated to incorporate terms required in connection with the 2012-1 and 2012A financings (see Note 6).

## NOTE 2 - Summary of Significant Accounting Policies

*Cash and cash equivalents*

Cash and cash equivalents consist of a checking account and a short-term investment in commercial paper. The amounts may exceed federally insured limits. Cash pledged as collateral for securities included in long-term debt is excluded from cash and cash equivalents and presented in these consolidated financial statements as restricted cash and cash equivalents.

*Student loans and allowance for loan losses*

The Company's portfolio of student loans consists of federal and private student loans. Federal loans have an estimated twenty-five year life and the private loans have an estimated fifteen to twenty year life. Federal loans are recorded at cost, and include unamortized premium costs on the Consolidated Statements of Financial Position. The Company utilizes the interest method to amortize these costs, taking into account actual loan prepayments.

**NOTE 2 - Summary of Significant Accounting Policies** (cont.)

Federal student loans are guaranteed by the Department of Education ("DOE"), with reimbursement rates ranging from 97% to 100% of principal and related interest balances. Pursuant to federal regulations, the Company is required to repurchase (from the respective guarantor) a loan that was paid as a bankruptcy claim if the bankruptcy is subsequently dismissed by the court or, as a result of the hearing, the loan is considered non-dischargeable and the borrower is responsible for repayment of the loan. Due to management's historical experience with its portfolio of federal loans and the guarantee, no provision for federal student loan losses has been provided for by management in the consolidated financial statements.

Private loans are recorded at cost and reported net of the allowance for loan losses ("allowance") on the Consolidated Statements of Financial Position. The Company's allowance represents a reserve for the probable and inherent losses on the Company's private student loans. Following the guidance under Accounting Standard Codification (ASC) 450-20, management evaluates the allowance on a quarterly basis to ensure the reserve is adequate to reflect any potential losses to be incurred. As all private loans are considered as having similar risk characteristics (the majority were originated under the same stringent underwriting guidelines, to similar high-quality schools, etc.), the evaluation and analysis is performed on the entire pool of private loans. The evaluation includes a review of historical losses and any new trends and conditions (including the general economic environment) that may impact the Company's ability to collect on its portfolio of private loans. The evaluation and analysis resulting from these reviews are used in management's determination of the amount of the allowance. During the fiscal year ended September 30, 2014, management implemented an enhanced approach to the manner in which historical losses are incorporated into the estimate of the allowance for loan losses. This enhancement, which uses a more recent look-back period for reviewing historical loss patterns, results in an estimate that is more reflective of the probable performance of the underlying loans as of September 30, 2014 (see Note 4).

Defaulted loans are charged-off to the allowance when a loan is greater than 180 days delinquent and after consideration has been made regarding the borrower's financial condition and collection efforts have been exhausted. Subsequent recoveries of accounts previously charged-off are recorded to the allowance.

Management believes the allowance for loan losses is adequate as of September 30, 2014 and 2013. While management used available information to estimate losses on private loans, future adjustments to the allowance for loan losses may be necessary based on changes in economic conditions.

*Loan premiums*

Loan premiums consist of origination and lender fees paid to the DOE on federal loans originated by the Company, premiums paid in the acquisition of student loans and certain expenses incurred to originate student loans. The Company utilizes the interest method to amortize these costs, taking into account actual loan prepayments. Student loan interest income is shown net of amortization of premiums of $10,029 and $10,783 for the years ended September 30, 2014 and 2013, respectively, on the Consolidated Statements of Activities.

## NOTE 2 - Summary of Significant Accounting Policies (cont.)

*Servicer receivable*

Servicer receivable represents student loan principal and interest payments collected and applied to borrower balances by the Company's third party servicer (Great Lakes Educational Loan Services, Inc.) that have not yet been remitted to the Company. No allowance was deemed as necessary as of September 30, 2014 and 2013.

*Restricted cash and cash equivalents*

The Company's restricted cash and cash equivalents include cash pledged as collateral for securities included in long-term debt. Cash pledged as collateral is held by a trustee in various accounts subject to use restrictions imposed by trust indentures and agreements specific to each of the Company's security issues. Pursuant to stipulations in these indentures and agreements, cash held in trust funds must be used for distributions as required under the specific financing obligations. Restricted cash and cash equivalents consist of cash management accounts, money market funds, and other operating accounts invested in high quality short-term financial instruments. The amounts may exceed federally insured limits.

*Debt issuance costs*

The Company's debt issuance costs are amortized at the rate the corresponding debt is paid down.

*Government payable*

Government payable represents payments due to the DOE for borrower interest earned on federal loans which is in excess of the Special Allowance Payments ("SAP") formula, as established under The Higher Education Act of 1965 (the "Act"). See Student loan interest income - Federal Loans below.

*Income taxes*

The Company is a tax-exempt organization set up under the provisions of the Internal Revenue Code Section 501(c) (3).

Management accounts for uncertainty in income taxes based on a threshold of more-likely than-not for recognition of tax positions taken or expected to be taken in a tax return. The Company has no uncertain tax positions meeting the threshold. Federal returns for tax years after 2009 remain subject to examination by the Internal Revenue Service.

*Net assets*

Net assets, revenues, gains, and losses are classified based on the existence or absence of restrictions. Accordingly, net assets of the Company are classified and reported as follows:

Unrestricted Net Assets - Unrestricted net assets include net assets which are not subject to any restrictions.

## NOTE 2 - Summary of Significant Accounting Policies (cont.)

*Principles of consolidation*

The consolidated financial statements for the year ended September 30, 2014 and 2013 include the accounts of NEF and the accounts associated with the beneficial interests of its subsidiary, Northstar Education Funding I, LLC, the depositor entity which holds all beneficial interests in the loans pledged to two trusts specific to NEF's financings completed in October 2012 (see Note 6).

*Student loan interest income*

Federal loans

The Company's federally-guaranteed student loans were originated under the Federal Family Education Loan Program (FFELP). The Company earns interest at the greater of the borrower's rate or a floating rate which is based on 1-month London Inter Bank Offered Rate (LIBOR). If the floating rate exceeds the borrower rate, the DOE makes a payment directly to the Company based upon SAP formulas established under the Act. If the floating rate is less than the rate the borrower is obligated to pay, the Company earns interest at the borrower rate on all loans with first disbursements prior to April 1, 2006. For loans with first disbursements on or after April 1, 2006, the Company must remit back to the Department of Education on a quarterly basis any borrower interest in excess of the SAP formula. The interest rates on the majority of the Company's federal loans are fixed to term, with a small number of others with variable rates based on the 91-day U.S. Treasury bill. Student loan interest income is shown net of amortization of premiums on the Consolidated Statements of Activities.

Private loans

The Company's private student loans have variable interest rates that reset quarterly.

*Interest expense*

The Company has financed its student loan portfolio with securities which have interest rates that, based on contractual agreements, are indexed to U.S. Treasury bill rates or LIBOR.

*Loan consolidation fees*

Loan consolidation fees represent monthly rebate fees paid to the DOE which are required of lenders who hold consolidation loans. The rate used to calculate the fee is determined by the date the loan was disbursed and is applied to the principal amount plus accrued unpaid interest on the loan to calculate the amount of the monthly fees due.

*Reclassifications*

For comparability, certain 2013 amounts have been reclassified to conform to classifications adopted in 2014. This had no impact on the 2013 change in net assets or the net assets as of September 30, 2013.

(in thousands)

## NOTE 2 - Summary of Significant Accounting Policies (cont.)

*Use of estimates*

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## NOTE 3 - Loans, Net

Loans, net, consisted of the following as of September 30, 2014 and 2013 :

| | 2014 | 2013 |
|---|---|---|
| Federal guaranteed student loans | $ 3,177,070 | $ 3,440,873 |
| Private student loans | 414,083 | 466,567 |
| Unamortized loan premiums | 59,447 | 69,476 |
| Loan repurchases in transit | - | 46 |
| Total | 3,650,600 | 3,976,962 |
| Allowance for loan losses on private student loans (Note 4) | (6,649) | (15,240) |
| Loans, net | $ 3,643,951 | $ 3,961,722 |

## NOTE 4 - Allowance for Loan Losses

The change in the allowance for loan losses for the years ended September 30, 2014 and 2013 consisted of the following:

| | 2014 | 2013 |
|---|---|---|
| Beginning balance | $ 15,240 | $ 13,007 |
| Provision for loan losses | (5,757) | 4,797 |
| Charge-offs, net of recoveries | (2,834) | (2,564) |
| Ending balance | $ 6,649 | $ 15,240 |

The Company's allowance represents a reserve for the estimates losses on the Company's private student loans. Following the guidance under Accounting Standard Codification (ASC) 450-20, management evaluates the allowance on a quarterly basis to ensure the reserve is adequate to reflect any probable and inherent losses to be incurred. As all private loans are considered as having similar risk characteristics (the majority were originated under the same stringent underwriting guidelines, to similar high-quality schools, etc.), the evaluation and analysis is performed on the entire pool of private loans. The evaluation includes a review of historical losses and any new trends and conditions (including the general economic environment) that may impact the Company's ability to collect on its private loans. The evaluation and analysis resulting from these reviews are used in management's determination of the amount of the allowance.

(in thousands)

### **NOTE 4 - Allowance for Loan Losses** (cont.)

During the fiscal year ended September 30, 2014, principally due to the fact that the Company's private loan portfolio, as a whole, is believed to be well-seasoned, management implemented an enhanced approach to the manner in which it incorporates historical losses into its estimate of the allowance for loan losses. A significant number of the private loans are now in repayment (over 90%), and over 70% of these have been in repayment for more than four years. The enhanced approach, which management believes accurately reflects the probability of repayment as of September 30, 2014, uses a more recent historical look-back period for applying historical loss patterns. The result of this enhancement was a reduction to the allowance of approximately $5 million, which was recorded to the Provision for loan losses in the Statement of Activities for the fiscal year ended September 30, 2014.

As of September 30, 2014 and 2013, student loans totaling approximately $36 million were 91 days or more delinquent. Of the $36 million, approximately $31 million were federal guaranteed student loans and approximately $5 million were private student loans.

Information about the credit quality of private loans for the years ended September 30, 2014 and 2013 is as follows:

| | 2014 | | |
|---|---|---|---|
| | Outstanding balance | Percentage of repayment | Percentage of total |
| In school and grace | $ 3,693 | | 0.9 % |
| Deferment | 21,769 | | 5.3 |
| Forbearance | 4,337 | | 1.0 |
| Repayment | | | |
| Current | 367,144 | 95.6 % | |
| Delinquent 31-60 days | 8,961 | 2.3 | |
| Delinquent 61-90 days | 2,804 | 0.7 | |
| Delinquent 91 days or greater | 5,375 | 1.4 | |
| Total in repayment | 384,284 | 100.0 % | 92.8 |
| Total | $ 414,083 | | 100.0 % |

(in thousands)

## NOTE 4 - Allowance for Loan Losses (cont.)

| | 2013 | | |
|---|---|---|---|
| | Outstanding balance | Percentage of repayment | Percentage of total |
| In school and grace | $ 11,500 | | 2.5 % |
| Deferment | 34,515 | | 7.4 |
| Forbearance | 5,551 | | 1.2 |
| Repayment | | | |
| Current | 395,624 | 95.3 % | |
| Delinquent 31-60 days | 10,388 | 2.5 | |
| Delinquent 61-90 days | 3,673 | 0.9 | |
| Delinquent 91 days or greater | 5,316 | 1.3 | |
| Total in repayment | 415,001 | 100.0 % | 88.9 |
| Total | $ 466,567 | | 100.0 % |

The Company's private loans were originated using the Company's stringent program guidelines, with loans being made only to eligible borrowers at eligible schools. Borrower eligibility was determined through a proprietary credit underwriting process utilizing credit scoring models, strict co-signer requirements and consideration of other factors such as school eligibility. School eligibility was determined by the Company, based on the school's historical default experience. All loan servicing functions are performed by Great Lakes Educational Loan Services, Inc. To supplement these services, NES performs additional collection activities through its Default Management Program.

Because each of the loans in the Company's federal loan portfolio are guaranteed at a level between 97% and 100%, management believes the aggregate risk of loss is not meaningful to the financial condition of the Company. Accordingly, no allowance for loan losses has been established for these loans, and the detailed credit quality information similar to that presented for the Company' private loan portfolio has been intentionally omitted.

## NOTE 5 - Sale of Subsidiary

On August 30, 2010, the Company increased its investment in NCMS by purchasing an additional 2% interest from a non-controlling party and simultaneously selling all of its then interests in NCMS to an unrelated party, liquidating all of the Company's investment and control in the subsidiary. See Note 1 for additional information on NCMS.

The general terms of the stock sale included a gross sales price of approximately $40 million for all outstanding shares of NCMS. Approximately $6.2 million of these funds were set aside and subject to certain contingent obligations. These funds were restricted until on or after February 28, 2013, subject to written request of the sellers' representative. Based on the terms of the agreement, the Company recorded a gain on the sale of approximately $14.7 million with an additional $3.5 million recorded as a contingent gain to be recognized when certain restrictions were released by the acquirer.

## NOTE 5 - Sale of Subsidiary (cont.)

During the fiscal year ended September 30, 2013, certain conditions were met and restrictions released by the acquirer. As a result, a release was made from the restricted sellers' escrow funds and distributed to the sellers. Accordingly, the Company recorded a $1.9 million "Gain on sale of investment in subsidiary". Approximately $1.4 million was paid to the former non-controlling interests.

Additionally during the fiscal year ended September 30, 2013, as pursuant to the terms of the stock sale, the Company met other conditions associated with the refinancing of its bank lines of credit. As a result, a distribution of approximately $2.1 million was made to NEF, which was recorded as a "Gain on sale of investment of subsidiary".

## NOTE 6 - Long-Term Debt

The Company has, from time to time, issued taxable student loan asset-backed notes to finance its student loans as follows:

*Years 2000-2007*

The Company issued a series of securities under two separate master trusts. One of the trusts is secured by a pool of federally-guaranteed student loans originated under the Federal Family Education Loan Program ("FFELP Master Trust").The other trust is secured by a pool of private student loans. The securities issued under these two master trusts are secured by the respective federal and private loan portfolios, accrued interest on the loans, and other assets pledged as collateral in each of the respective trusts.

The notes issued by the Company included senior and subordinate LIBOR rate notes and senior reset rate notes, all of which were issued at a fixed spread to 3-month LIBOR. The senior LIBOR rate notes issued under the FFELP Master Trust were issued at a fixed maturity with targeted amortization schedules. The Company also issued senior and subordinate auction rate notes with interest rates that are reset every 28 days based upon auction procedures. These securities have approximate forty year maturities with prepayment at the option of the Company.

As of both September 30, 2014 and 2013, the Company held $798 million of taxable auction rate notes. Beginning in February 2008, a disruption in the auction rate securities market has resulted in failures in auctions on these notes. As a result, all of the Company's auction rate notes bear interest at the maximum rate allowable under their terms. The maximum allowable interest rate on the $798 million of taxable auction rate securities is based on the 91 day U.S. Treasury Bill plus 1.20% on the AAA rated securities and the 91 day U.S. Treasury Bill plus 1.50% on the A rated securities. The rates reset every 28 days. The maximum rate is based on a rolling 13-month reset period average.

The Company's reset rate notes are subject to periodic remarketing, at which time the interest rates on the reset rate notes are reset. In the event a reset rate note cannot be remarketed on its remarketing date, and is not repurchased, the interest rate generally steps up to and remains at 3-month LIBOR plus 0.75 percent, until such time as the bonds are successfully remarketed or refinanced. As of September 30, 2013, $267 million of reset rate notes, representing two tranches of asset-backed securities, yielded interest rates at 3-month LIBOR plus 0.75 percent due to failed remarketing. In January 2014, an additional $235 million of reset rate notes which, based on a failed remarketing, had their interest rate stepped up to the 3-month LIBOR plus 0.75 percent.

(in thousands)

## NOTE 6 - Long-Term Debt (cont.)

*Year 2011*

In May 2011, the Company completed a loan sale and refinance, which included the issuance of loan participation promissory notes which bear interest at a fixed spread to 1-month LIBOR. NEF invested approximately $8.6 million of its own funds to complete this transaction.

*Year 2012*

On October 25, 2012, NEF completed two separate asset-backed refinancings totaling $785.3 million, for the purpose of using the proceeds to repay the Company's two lines of credit. The two refinancings included one structured issue totaling $686.6 million secured by a portfolio of federally insured FFELP student loans (NorthStar Student Loan Trust I, or the "2012-1" Issue), and one private issue totaling $98.7 million secured by a portfolio of private student loans and backed by a letter of credit issued by Royal Bank of Canada (NorthStar Student Loan Trust II, or the "2012A" Issue).

The notes and bonds issued under both the 2012-1 and 2012A issues are obligations of separate trusts, NorthStar Student Loan Trust I and NorthStar Student Loan Trust II, respectively. Notes issued in conjunction with the 2012-1 refinancing included senior LIBOR notes at a fixed spread to 1-month LIBOR, and subordinate notes at a fixed spread to 3-month LIBOR. Notes issued in conjunction with the 2012A refinancing included adjustable rate revenue bonds, with a variable interest rate based on 1-month LIBOR. NEF, as the Sponsor, invested approximately $8.9 million in total to both issues to complete the refinancing transactions.

The Company's outstanding balance of long-term debt by issue and type of security, and current interest rates consisted of the following as of September 30, 2014 and 2013:

| LIBOR Notes | Final Maturity | 2014 | 2013 | 2014 Current Interest Rate |
|---|---|---|---|---|
| Series 2004-1A-4 | 4/29/2019 | $ - | $ 67,000 | N/A |
| Series 2004-2A-1 | 4/28/2016 | - | 51,274 | N/A |
| Series 2004-2A-2 | 1/30/2017 | 107,347 | 150,000 | 0.38 % |
| Series 2004-2A-3 | 7/30/2018 | 280,000 | 280,000 | 0.41 |
| Series 2004-2A-4 | 7/28/2021 | 249,500 | 249,500 | 0.47 |
| Series 2005-1A-1 | 10/28/2026 | 12,184 | 67,900 | 0.34 |
| Series 2005-1A-2 | 7/28/2027 | 118,300 | 118,300 | 0.37 |
| Series 2005-1A-3 | 10/30/2030 | 227,900 | 227,900 | 0.41 |
| Series 2005-1A-4 | 4/28/2032 | 210,700 | 210,700 | 0.47 |
| Series 2006A-A3 | 5/28/2026 | 31,621 | 69,585 | 0.45 |
| Series 2006A-A4 | 8/28/2035 | 208,056 | 208,056 | 0.59 |
| Series 2006A-B | 11/28/2035 | 45,689 | 52,925 | 0.79 |
| Series 2007-1A-1 | 4/28/2030 | 193,000 | 193,000 | 0.34 |
| Series 2012-1A-1 | 12/26/2031 | 517,020 | 600,857 | 0.85 |
| Series 2012-1B-1 | 1/25/2032 | 5,893 | 8,603 | 5.23 |
| Total LIBOR Notes | | $ 2,207,210 | $ 2,555,600 | |

(in thousands)

**NOTE 6 - Long-Term Debt** (cont.)

| Reset Rate Notes | Final Maturity | 2014 | 2013 | 2014 Current Interest Rate |
|---|---|---|---|---|
| Series 2005-1A-5 | 10/30/2045 | $ 67,342 | $ 67,342 | 0.99 % |
| Series 2007-1A-2 | 1/29/2046 | 200,000 | 200,000 | 0.99 |
| Series 2007-1A-3 | 1/29/2046 | 235,000 | 235,000 | 0.99 |
| Total Reset Rate Notes | | $ 502,342 | $ 502,342 | |

| Auction Rate Notes | Final Maturity | 2014 | 2013 | 2014 Current Interest Rate |
|---|---|---|---|---|
| Series 2000-B | 11/1/2040 | $ 9,500 | $ 9,500 | 1.57 % |
| Series 2002-A | 4/1/2042 | 233,500 | 233,500 | 1.52-2.13 |
| Series 2002-B | 4/1/2042 | 37,000 | 37,000 | 2.87 |
| Series 2004-1B | 12/1/2044 | 30,000 | 30,000 | 1.15 |
| Series 2004-2B | 2/28/2044 | 25,500 | 25,500 | 1.55 |
| Series 2005-1B | 10/30/2045 | 20,000 | 20,000 | 1.55 |
| Series 2007-1A | 1/29/2046 | 410,150 | 410,150 | 1.45-1.63 |
| Series 2007-1B | 1/28/2047 | 32,200 | 32,200 | 1.55 |
| Total Auction Rate Notes | | $ 797,850 | $ 797,850 | |

| Loan Participation Promissory Notes | Final Maturity | 2014 | 2013 | 2014 Current Interest Rate |
|---|---|---|---|---|
| Series 2011-A-L | 10/25/2034 | $ 13,599 | $ 15,462 | 4.15 % |

| Adjustable Rate Revenue Bonds | Final Maturity | 2014 | 2013 | 2014 Current Interest Rate |
|---|---|---|---|---|
| Series 2012A | 10/1/2042 | $ 80,672 | $ 90,770 | 0.10 % |
| Total Long-Term Debt | | $ 3,601,673 | $ 3,962,024 | |

Pursuant to trust indentures and agreements associated with the specific issues, the Company is required, among other things, to maintain certain financial covenants and ratios.

(in thousands)

## NOTE 7 - Significant Risks and Concentrations

The Company's business is primarily focused on helping students obtain an affordable education, managing its portfolio of federal and private student loans, and overseeing its financings to maximize the T.H.E. Bonus paid to its student borrowers. Because of the Company's concentration in one industry, it is exposed to credit, legislative, operational, regulatory and liquidity risks associated with the student loan industry.

As of September 30, 2014, the Company's portfolio of student loans was comprised of approximately 88% federal and 12% private student loans. The Company's private loans are unsecured. The government subsidized loans are substantially guaranteed. As a result of legislation changes in 2010 (see Note 1), all federal loans are now made through the DSLP. The terms and conditions of the Company's FFELP loans were not affected by this legislation. However, Congress and its Administration still exercise significant authority over the servicing and administration of existing FFELP loans. Because of the ongoing uncertainty around efforts to reduce the federal budget deficit, the timing, method and manner of implementation of various education lending initiatives has become less predictable. This, and general economic conditions may impact the Company's ability to collect loans and interest from students.

The Company receives periodic payments from its primary contract loan servicer. These amounts are generally unsecured from the time student loan payments are received by the contract loan servicer until the time they are remitted to the Company.

## NOTE 8 - Fair Value of Financial Instruments

As of September 30, 2014 and 2013, estimated fair values of the Company's financial instruments were as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Carrying Amounts | Estimated Fair Value | Carrying Amounts | Estimated Fair Value |
| **Financial assets** | | | | |
| Cash and cash equivalents | $ 7,391 | $ 7,391 | $ 9,688 | $ 9,688 |
| Loans, net | 3,643,951 | 3,643,951 | 3,961,722 | 3,961,722 |
| Interest receivable | 49,587 | 49,587 | 64,003 | 64,003 |
| Servicer receivable | 11,106 | 11,106 | 9,936 | 9,936 |
| Restricted cash and cash equivalents | 120,792 | 120,792 | 123,505 | 123,505 |
| **Financial liabilities** | | | | |
| Accounts payable and accrued liabilities | 7,940 | 7,940 | 9,947 | 9,947 |
| Government payable | 9,715 | 9,715 | 10,768 | 10,768 |
| Long-term debt | 3,601,673 | 3,346,928 | 3,962,024 | 3,589,083 |

## NOTE 8 - Fair Value of Financial Instruments (cont.)

The following methods and assumptions are used by the Company in estimating the fair value of its financial instruments:

***Cash and cash equivalents:*** The carrying amount of cash and cash equivalents is a reasonable estimate of fair value.

***Loans:*** Because there is currently no transparency to the secondary market for student loans with characteristics similar to NEF's, it is not reasonably practical to determine the fair value of this portfolio. Because of the high level of credit quality of the portfolio as a whole and the current weighted average yield, it is most likely that, if sold, the portfolio would be valued at a modest premium, offset by the costs necessary to execute the transfer of this portfolio. Accordingly, for purposes of this disclosure, amortized cost is believed to approximate fair value.

***Interest receivable*:** The carrying amount approximates fair value due to the short maturity of this instrument and the Company's experience in collecting this receivable.

***Servicer receivable:*** The carrying amount approximates fair value due to the short maturity of this instrument and the Company's experience in collecting this receivable.

***Restricted cash and cash equivalents:*** The carrying amount of restricted cash and cash equivalents is a reasonable estimate of fair value.

***Accounts payable and accrued liabilities:*** The carrying amount approximates fair value due to the short maturity of these instruments and the Company's experience in paying these liabilities.

***Government payable:*** The carrying amount approximates fair value due to the short maturity of this instrument and the Company's experience in paying this liability.

***Long-term debt:*** The estimate of fair value of long-term debt is based on market valuation data.

## NOTE 9 - Commitments and Contingencies

*Asserted claims*

Business Suspension Litigation

The Company was a defendant in four similar nationwide class action cases which alleged that the Company's suspension of the "bonus" benefit of its student loans in February 2008 was unlawful. All four actions were consolidated by the United States Judicial Panel on Multidistrict Litigation, under the caption *In Re Northstar Education Finance, Inc., Contract Litigation,* MDL No. 1990 in the United States District Court for Minnesota on December 3, 2008.

## NOTE 9 - Commitments and Contingencies (cont.)

Following consolidation and certification of the class, the Company entered into settlement negotiations with counsel for the plaintiffs in the MDL action. The Company and counsel for the plaintiffs negotiated a Stipulation for Class Action Settlement (the "Settlement"). The Settlement was preliminarily approved by the Court on December 21, 2009, notice of the Settlement was transmitted to all class members, and final approval of the Settlement was received on April 8, 2010. The time for an appeal of the final approval of the Settlement expired on May 10, 2010, without appeal. Accordingly, these claims have been resolved.

The provisions of the Settlement included a requirement that the Company guarantee a minimum distribution of bonus benefit payments to Settlement class members totaling $1.25 million each year for five years after the effective date of the Settlement. Additional provisions of the Settlement included a requirement that the Company pay class counsel attorneys' fees over several years as follows:

- An amount of $1 million within five business days of the signing of the Settlement agreement
- An amount totaling $250 thousand on each anniversary date of the Settlement effective date in each subsequent year two through five. Pursuant to a letter agreement dated October 4, 2011, plaintiff's counsel agreed to accept $220 thousand for the first payment
- An additional $2.5 million in attorney's fees, which are not guaranteed, and which are based on excess cash releases pursuant to trust indentures and agreements, to begin in 2016, the sixth year after the effective date of the Settlement

As of September 30, 2014, remaining guaranteed payments to be made under the Settlement included approximately $916 of guaranteed bonus benefits due in May 2015. These guaranteed payments are included in Accounts payable and accrued liabilities on the Consolidated Statement of Financial Position as of September 30, 2014.

The Company was also required to reinstate its borrower benefit program, under the terms and conditions set forth in the Settlement agreement as feasible, subject to requirements of its financing covenants and borrower eligibility.

## NOTE 10 - Subsequent Events

Management has evaluated subsequent events through December 10, 2014, the date which the consolidated financial statements were available to be issued. No events or transactions have occurred requiring adjustments to or disclosures in the consolidated financial statements.