

NELNET INC  
Form 10-Q  
November 09, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended September 30, 2012

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the transition period from to .

COMMISSION FILE NUMBER 001-31924

NELNET, INC.

(Exact name of registrant as specified in its charter)

NEBRASKA

(State or other jurisdiction of incorporation or  
organization)

84-0748903

(I.R.S. Employer Identification No.)

121 SOUTH 13TH STREET, SUITE 201

LINCOLN, NEBRASKA

68508

(Zip Code)

(Address of principal executive offices)

(402) 458-2370

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]

Accelerated filer [X]

Non-accelerated filer [ ]

Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

As of October 31, 2012, there were 35,835,327 and 11,495,377 shares of Class A Common Stock and Class B Common Stock, par value \$0.01 per share, outstanding, respectively (excluding 11,317,364 shares of Class A Common Stock held by wholly owned subsidiaries).

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September 30, 2012

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

NELNET, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

	As of September 30, 2012 (unaudited)	As of December 31, 2011
Assets:		
Student loans receivable (net of allowance for loan losses of \$48,209 and \$48,482, respectively)	\$22,559,341	24,297,876
Cash and cash equivalents:		
Cash and cash equivalents - not held at a related party	5,776	7,299
Cash and cash equivalents - held at a related party	87,898	35,271
Total cash and cash equivalents	93,674	42,570
Investments	92,860	50,780
Restricted cash and investments	905,561	614,322
Restricted cash - due to customers	98,327	109,809
Accrued interest receivable	267,856	308,401
Accounts receivable (net of allowance for doubtful accounts of \$1,796 and \$1,284, respectively)	71,399	63,654
Goodwill	117,118	117,118
Intangible assets, net	14,360	28,374
Property and equipment, net	32,752	34,819
Other assets	87,871	92,275
Fair value of derivative instruments	67,725	92,219
Total assets	\$24,408,844	25,852,217
Liabilities:		
Bonds and notes payable	\$22,884,096	24,434,540
Accrued interest payable	16,636	19,634
Other liabilities	153,282	178,189
Due to customers	98,327	109,809
Fair value of derivative instruments	80,265	43,840
Total liabilities	23,232,606	24,786,012
Equity:		
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 35,839,076 shares and 35,643,102 shares, respectively	358	356
Class B, convertible, \$0.01 par value. Authorized 60,000,000 shares; issued and outstanding 11,495,377 shares	115	115
Additional paid-in capital	52,843	49,245
Retained earnings	1,124,806	1,017,629
Accumulated other comprehensive loss	(1,933)	—

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Employee notes receivable	(368	) (1,140	)
Total Nelnet, Inc. shareholders' equity	1,175,821	1,066,205	
Noncontrolling interest	417	—	
Total equity	1,176,238	1,066,205	
Commitments and contingencies			
Total liabilities and equity	\$24,408,844	25,852,217	

See accompanying notes to consolidated financial statements.

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NELNET, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except share data)

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Interest income:				
Loan interest	\$ 150,528	156,955	454,574	433,247
Investment interest	1,140	672	3,290	2,254
Total interest income	151,668	157,627	457,864	435,501
Interest expense:				
Interest on bonds and notes payable	66,402	60,866	203,175	164,227
Net interest income	85,266	96,761	254,689	271,274
Less provision for loan losses	5,000	5,250	18,000	14,250
Net interest income after provision for loan losses	80,266	91,511	236,689	257,024
Other income (expense):				
Loan and guaranty servicing revenue	53,285	42,549	155,164	124,697
Tuition payment processing and campus commerce revenue	17,928	16,774	56,675	50,904
Enrollment services revenue	30,661	35,505	92,035	101,688
Other income	12,699	3,931	32,453	17,249
Gain on sale of loans and debt repurchases	195	—	1,130	8,307
Derivative market value and foreign currency adjustments and derivative settlements, net	(31,275)	(13,631)	(68,073)	(37,002)
Total other income	83,493	85,128	269,384	265,843
Operating expenses:				
Salaries and benefits	46,395	44,132	144,193	130,925
Cost to provide enrollment services	20,151	23,825	62,203	68,804
Depreciation and amortization	8,402	7,917	24,764	21,462
Other	29,989	28,904	93,160	83,776
Total operating expenses	104,937	104,778	324,320	304,967
Income before income taxes	58,822	71,861	181,753	217,900
Income tax expense	(21,870)	(24,410)	(59,978)	(78,444)
Net income	36,952	47,451	121,775	139,456
Net income attributable to noncontrolling interest	124	—	412	—
Net income attributable to Nelnet, Inc.	\$36,828	47,451	121,363	139,456
Earnings per common share:				
Net income attributable to Nelnet, Inc. shareholders - basic	\$0.78	0.98	2.56	2.88
Net income attributable to Nelnet, Inc. shareholders - diluted	\$0.77	0.98	2.55	2.87
Weighted average common shares outstanding:				
Basic	47,086,098	48,059,747	47,042,035	48,177,539
Diluted	47,321,797	48,253,888	47,267,036	48,367,923

See accompanying notes to consolidated financial statements.



NELNET, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Dollars in thousands)  
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income	\$36,952	47,451	121,775	139,456
Other comprehensive income (loss):				
Available-for-sale securities:				
Unrealized holding gains arising during period, net	133	—	1,745	—
Less reclassification adjustment for gains recognized in net income, net	(2,618	) —	(4,848	) —
Income tax effect	961	—	1,170	—
Total other comprehensive income (loss)	(1,524	) —	(1,933	) —
Comprehensive income	35,428	47,451	119,842	139,456
Comprehensive income attributable to noncontrolling interest	124	—	412	—
Comprehensive income attributable to Nelnet, Inc.	\$35,304	47,451	119,430	139,456

See accompanying notes to consolidated financial statements.

NELNET, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Dollars in thousands, except share data)  
(unaudited)

	Nelnet, Inc. Shareholders		Class Preferred stock	Class B common stock	Additional paid-in common capital	Retained earnings	Accumulated other comprehensive loss	Employee notes receivable	Nonconforming interest	Totaling equity
	Common stock Preferred Class A shares	Common stock Class B shares								
Balance as of June 30, 2011	—37,044,372	11,495,377	\$—370	115	74,646	914,823	—	(1,170)	—	988,784
Net income	—	—	—	—	—	47,451	—	—	—	47,451
Cash dividend on Class A and Class B common stock - \$0.10 per share	—	—	—	—	—	(4,811)	—	—	—	(4,811)
Issuance of common stock, net of forfeitures	—17,157	—	— 1	—	314	—	—	—	—	315
Compensation expense for stock based awards	—	—	—	—	310	—	—	—	—	310
Repurchase of common stock	—(1,097,441)	—	— (11)	—	(20,585)	—	—	—	—	(20,596)
Payments received on employee stock notes receivable	—	—	—	—	—	—	—	30	—	30
Balance as of September 30, 2011	—35,964,088	11,495,377	\$—360	115	54,685	957,463	—	(1,140)	—	1,011,483
Balance as of June 30, 2012	—35,847,801	11,495,377	\$—358	115	52,194	1,092,715	(409)	(368)	293	1,144,898
Net income	—	—	—	—	—	36,828	—	—	124	36,952
Other comprehensive loss	—	—	—	—	—	—	(1,524)	—	—	(1,524)
Cash dividend on Class A and Class B common stock - \$0.10 per share	—	—	—	—	—	(4,737)	—	—	—	(4,737)
Issuance of common stock, net of	—(180)	—	—	—	271	—	—	—	—	271

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forfeitures											
Compensation											
expense for											
stock based	—	—	—	—	584	—	—	—	—	584	
awards											
Repurchase of	(8,545	)	—	—	(206	)	—	—	—	(206	
common stock										)	
Balance as of											
September 30,	—35,839,076	11,495,377	\$—358	115	52,843	1,124,806	(1,933	)	(368	)	417
2012											
Balance as of											
December 31,	—36,846,353	11,495,377	\$—368	115	76,263	831,057	—	(1,170)	—	906,633	
2010											
Net income	—	—	—	—	—	139,456	—	—	—	139,456	
Cash dividend											
on Class A and											
Class B	—	—	—	—	—	(13,050	)	—	—	(13,050	
common stock -										)	
\$0.27 per share											
Contingency											
payment related	—	—	—	—	(5,893	)	—	—	—	(5,893	
to business										)	
combination											
Issuance of											
common stock,	—239,620	—	—	3	—	4,427	—	—	—	4,430	
net of											
forfeitures											
Compensation											
expense for	—	—	—	—	1,007	—	—	—	—	1,007	
stock based											
awards											
Repurchase of	(1,121,885	)	—	—	(11	)	—	—	—	(21,130	
common stock										)	
Payments											
received on	—	—	—	—	—	—	—	30	—	30	
employee stock											
notes receivable											
Balance as of											
September 30,	—35,964,088	11,495,377	\$—360	115	54,685	957,463	—	(1,140)	—	1,011,483	
2011											
Balance as of											
December 31,	—35,643,102	11,495,377	\$—356	115	49,245	1,017,629	—	(1,140)	—	1,066,205	
2011											
Issuance of											
noncontrolling	—	—	—	—	—	—	—	—	5	5	
interest											
Net income	—	—	—	—	—	121,363	—	—	412	121,775	
Other											
comprehensive	—	—	—	—	—	—	(1,933	)	—	(1,933	
loss										)	
	—	—	—	—	—	(14,186	)	—	—	(14,186	
										)	

Cash dividend on Class A and Class B common stock - \$0.30 per share										
Issuance of common stock, net of forfeitures	—255,538	—	— 3	—	3,545	—	—	—	—	3,548
Compensation expense for stock based awards	—	—	— —	—	1,573	—	—	—	—	1,573
Repurchase of common stock	—(59,564 )	—	— (1 )	—	(1,520 )	—	—	—	—	(1,521 )
Payments received on employee stock notes receivable	—	—	— —	—	—	—	—	772	—	772
Balance as of September 30, 2012	—35,839,076	11,495,377	\$—358	115	52,843	1,124,806	(1,933 )	(368 )	417	1,176,238

See accompanying notes to consolidated financial statements.

NELNET, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)  
(unaudited)

	Nine months ended September 30,	
	2012	2011
Net income attributable to Nelnet, Inc.	\$ 121,363	139,456
Net income attributable to noncontrolling interest	412	—
Net income	121,775	139,456
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, including loan and debt premiums/discounts and deferred origination costs	53,677	54,462
Provision for loan losses	18,000	14,250
Derivative market value adjustment	67,349	18,683
Foreign currency transaction adjustment	(6,186	) 10,902
(Payments) proceeds to terminate and/or amend derivative instruments, net	(6,430	) 2,301
Gain on sale of loans	(80	) (1,345 )
Gain from debt repurchases	(1,050	) (6,962 )
Gain from sale of available-for-sale securities, net	(4,848	) —
Change in investments - trading securities, net	(2,024	) (6,598 )
Deferred income tax benefit	(29,141	) (15,916 )
Non-cash compensation expense	2,166	1,574
Other non-cash items	621	(124 )
Decrease in accrued interest receivable	40,545	6,550
Increase in accounts receivable	(7,745	) (6,280 )
Decrease in other assets	2,330	1,065
Decrease in accrued interest payable	(2,998	) (3,207 )
Increase in other liabilities	14,636	3,135
Net cash provided by operating activities	260,597	211,946
Cash flows from investing activities:		
Purchases of student loans	(875,556	) (820,812 )
Purchases of student loans from a related party	(299	) (59 )
Net proceeds from student loan repayments, claims, capitalized interest, participations, and other	2,500,005	1,778,729
Proceeds from sale of student loans	92,149	95,178
Purchases of available-for-sale securities	(155,057	) —
Proceeds from sales of available-for-sale securities	112,854	—
Purchases of property and equipment, net	(7,370	) (9,776 )
(Increase) decrease in restricted cash and investments, net	(291,239	) 101,009
Business and asset acquisition contingency payments	—	(14,029 )
Net cash provided by investing activities	1,375,487	1,130,240
Cash flows from financing activities:		
Payments on bonds and notes payable	(2,795,019	) (2,386,461 )
Proceeds from issuance of bonds and notes payable	1,232,250	995,644
Payments on bonds payable due to a related party	—	(107,050 )
Payments of debt issuance costs	(7,630	) (2,282 )
Dividends paid	(14,186	) (13,050 )

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Repurchases of common stock	(1,521 )	(21,130 )
Proceeds from issuance of common stock	349	406
Payments received on employee stock notes receivable	772	30
Issuance of noncontrolling interest	5	—
Net cash used in financing activities	(1,584,980 )	(1,533,893 )
Net increase (decrease) in cash and cash equivalents	51,104	(191,707 )
Cash and cash equivalents, beginning of period	42,570	283,801
Cash and cash equivalents, end of period	\$93,674	92,094
Supplemental disclosures of cash flow information:		
Interest paid	\$179,007	153,167
Income taxes paid, net of refunds	\$86,798	97,640
Noncash activity:		
Investing activity - Student loans acquired	\$—	1,716,681
Operating activity - Other assets acquired and other liabilities assumed, net	\$—	50,336
Financing activity - Borrowings assumed in acquisition of student loans and other assets	\$—	1,741,017
See accompanying notes to consolidated financial statements.		

## NELNET, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Information as of September 30, 2012 and for the three and nine months ended

September 30, 2012 and 2011 is unaudited)

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

## 1. Basis of Financial Reporting

The accompanying unaudited consolidated financial statements of Nelnet, Inc. and subsidiaries (the "Company") as of September 30, 2012 and for the three and nine month periods ended September 30, 2012 and 2011 have been prepared on the same basis as the audited consolidated financial statements for the year ended December 31, 2011 and, in the opinion of the Company's management, the unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of results of operations for the interim periods presented. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results for the year ending December 31, 2012. The unaudited consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

## Noncontrolling Interest

Noncontrolling interest reflects the proportionate share of membership interest (equity) and net income attributable to the holders of minority membership interests in Whitetail Rock Capital Management, LLC ("WRCM"), a subsidiary of the Company that issued minority membership interests on January 1, 2012.

## 2. Student Loans Receivable and Allowance for Loan Losses

Student loans receivable consisted of the following:

	As of September 30, 2012	As of December 31, 2011		
Federally insured loans				
Stafford and other	\$6,652,639	7,480,182		
Consolidation	15,962,969	16,852,527		
Total	22,615,608	24,332,709		
Non-federally insured loans	29,272	26,916		
	22,644,880	24,359,625		
Loan discount, net of unamortized loan premiums and deferred origination costs	(37,330	) (13,267	)	
Allowance for loan losses – federally insured loans	(35,614	) (37,205	)	
Allowance for loan losses – non-federally insured loans	(12,595	) (11,277	)	
	\$22,559,341	24,297,876		
Allowance for federally insured loans as a percentage of such loans	0.16	% 0.15	%	
Allowance for non-federally insured loans as a percentage of such loans	43.03	% 41.90	%	

## 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.

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Balance at beginning of period	\$49,657	42,300	48,482	43,626
Provision for loan losses:				
Federally insured loans	5,000	5,000	18,000	13,500
Non-federally insured loans	—	250	—	750
Total provision for loan losses	5,000	5,250	18,000	14,250
Charge-offs:				
Federally insured loans	(5,449)	(3,978)	(16,943)	(13,418)
Non-federally insured loans	(1,058)	(1,175)	(2,355)	(3,395)
Total charge-offs	(6,507)	(5,153)	(19,298)	(16,813)
Recoveries - non-federally insured loans	399	350	1,104	1,003
Purchase (sale) of loans, net:				
Federally insured loans	(928)	2,200	(2,647)	2,200
Non-federally insured loans	—	—	—	—
Total purchase (sale) of loans, net	(928)	2,200	(2,647)	2,200
Transfer from repurchase obligation related to loans purchased, net	588	826	2,568	1,507
Balance at end of period	\$48,209	45,773	48,209	45,773
Allocation of the allowance for loan losses:				
Federally insured loans	\$35,614	35,190	35,614	35,190
Non-federally insured loans	12,595	10,583	12,595	10,583
Total allowance for loan losses	\$48,209	45,773	48,209	45,773

## Repurchase Obligations

As of September 30, 2012, the Company had participated a cumulative amount of \$107.7 million of non-federally insured loans to third parties. Loans participated under these agreements have been accounted for by the Company as loan sales. Accordingly, the participation interests sold are not included in the Company's consolidated balance sheets. Per the terms of the servicing agreements, the Company's servicing operations are obligated to repurchase loans subject to the participation interests in the event such loans become 60 or 90 days delinquent.

In addition, on January 13, 2011, the Company sold a portfolio of non-federally insured loans for proceeds of \$91.3 million (100% of par value). The Company retained credit risk related to this portfolio and will pay cash to purchase back any loans which become 60 days delinquent.

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.

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Beginning balance	\$17,243	20,689	19,223	12,600
Transfer to the allowance for loan losses related to loans purchased, net	(588)	(826)	(2,568)	(1,507)

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Repurchase obligation associated with loans sold on	—	—	—	6,270
January 13, 2011	—	—	—	2,500
Current period expense	—	—	—	2,500
Ending balance	\$16,655	19,863	16,655	19,863

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## 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 table below shows the Company's student loan delinquencies.

	As of September 30, 2012		As of December 31, 2011		As of September 30, 2011	
Federally Insured Loans:						
Loans in-school/grace/deferment (a)	\$3,254,654		\$3,664,899		\$4,358,786	
Loans in forbearance (b)	2,997,330		3,330,452		3,390,367	
Loans in repayment status:						
Loans current	14,091,408	86.1 %	14,600,372	84.2 %	14,555,949	86.1 %
Loans delinquent 31-60 days (c)	637,994	3.9	844,204	4.9	675,053	4.0
Loans delinquent 61-90 days (c)	343,428	2.1	407,094	2.3	366,831	2.2
Loans delinquent 91-270 days (c)	1,000,250	6.1	1,163,437	6.7	1,060,385	6.3
Loans delinquent 271 days or greater (c)(d)	290,544	1.8	322,251	1.9	248,281	1.4
Total loans in repayment	16,363,624	100.0 %	17,337,358	100.0 %	16,906,499	100.0 %
Total federally insured loans	\$22,615,608		\$24,332,709		\$24,655,652	
Non-Federally Insured Loans:						
Loans in-school/grace/deferment (a)	\$2,315		\$2,058		\$2,944	
Loans in forbearance (b)	382		371		473	
Loans in repayment status:						
Loans current	18,951	71.3 %	16,776	68.5 %	19,209	74.9 %
Loans delinquent 31-60 days (c)	808	3.0	706	2.9	893	3.5
Loans delinquent 61-90 days (c)	1,959	7.4	1,987	8.1	1,344	5.2
Loans delinquent 91 days or greater (c)	4,857	18.3	5,018	20.5	4,198	16.4
Total loans in repayment	26,575	100.0 %	24,487	100.0 %	25,644	100.0 %
Total non-federally insured loans	\$29,272		\$26,916		\$29,061	

Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are (a) 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.

Loans for borrowers who have temporarily ceased making full payments due to hardship or other factors, (b) 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 federally insured loans in claim status, which are loans that have gone into default and have been submitted to the guaranty agency.

3. Bonds and Notes Payable

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

	As of September 30, 2012		
	Carrying amount	Interest rate range	Final maturity
Variable-rate bonds and notes (a):			
Bonds and notes based on indices	\$ 19,393,718	0.40% - 6.90%	11/25/15 - 7/27/48
Bonds and notes based on auction or remarketing	969,925	0.18% - 2.10%	5/1/28 - 5/25/42
Total variable-rate bonds and notes	20,363,643		