



MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis of NeighborWorks[®] Capital Corporation ("NC") provides an overall review of the Organization's financial and business activities for the fiscal year ended December 31, 2011. The intent of this discussion and analysis is to serve as an introduction to NeighborWorks[®] Capital Corporation's financial statements and to look at NeighborWorks[®] Capital Corporation's financial performance in the entirety. Recipients of this document should also review the notes to the financial statements to gain a greater understanding of NeighborWorks[®] Capital Corporation overall financial performance.

Background

NeighborWorks[®] Capital is a national community development loan fund based in Silver Spring, MD serving NeighborWorks[®] America affiliates ("NWOs") in all 50 states and the District of Columbia and is certified by the U.S. Department of the Treasury as a Community Development Financial Institution ("CDFI").

NeighborWorks[®] Capital's customers are NWOs in the real estate development line of business and its products provides flexible and affordable capital to NeighborWorks[®] America members by financing pre-development costs, acquisition of land and buildings, construction, rehabilitation, and preservation of NWO-owned rental properties that undertake property improvements that include green and energy saving components. NC does not offer permanent financing as this is typically available locally and nationally by financial institutions.

Mission

The mission of NeighborWorks[®] Capital Corporation ("NC") is to serve NeighborWorks[®] America organizations ("NWOs") by developing and enhancing resources for the acquisition, development, sale, financing, or ownership of affordable for-sale and rental properties and commercial projects. NC's exclusive purpose is to support the real estate development projects of these NWOs in their missions to preserve and create affordable housing opportunities for low and moderate income households, and to re-invest in deteriorated or otherwise blighted or economically depressed areas.

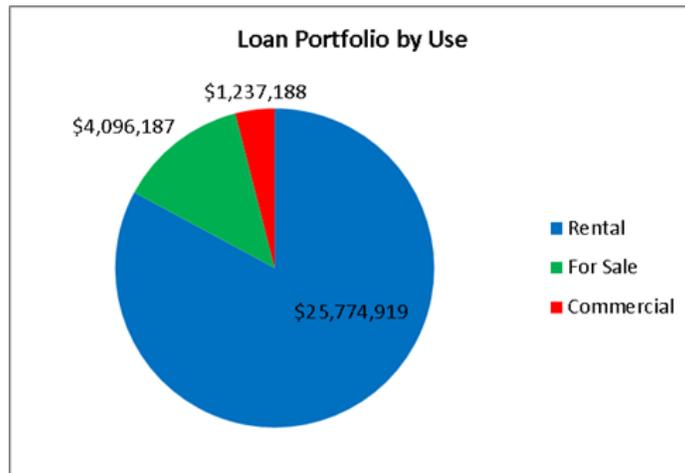
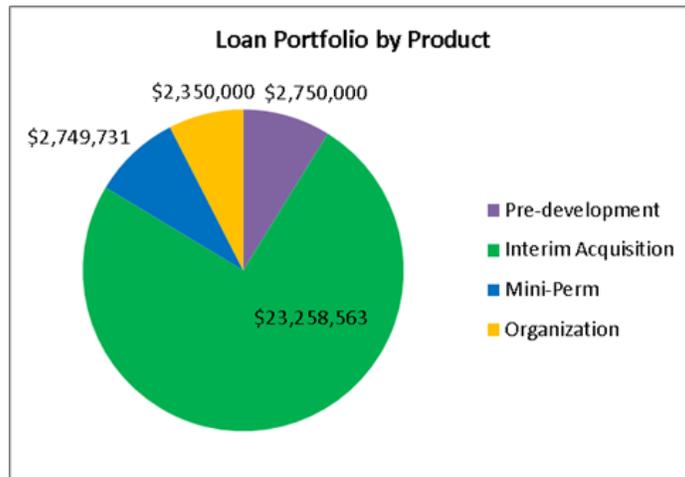
Annual Business Goals

In 2011 NeighborWorks[®] Capital achieved the following:

- Increased NC's lending volume by 9.6% over 2010
- Raised \$6.7 million in new lending capital
- Increased net assets by 22.4%
- Improved operating sustainability by 13%— now at 97%

- ☑ Increased NC's market share by 8% with 5 new customers
- ☑ CARS™ rated for the first time
- ☑ Originated \$15.2 million in loans, leveraging \$147 million in construction or permanent financing (10:1 leverage)
- ☑ Lending to 18 projects for 1,088 rental and for-sale housing units, of which 93% were affordable to individuals earning below 80% of area median income

NC has a strong and geographically diverse loan portfolio that utilized all loan products that are currently offered. The majority of its loans are real estate secured for acquisition of land and buildings for development or existing rental housing under renovation with an average maturity date of 27 months. The primary real estate type used for NC's loans is rental followed by for sale and commercial property.



NC has raised \$6.7 million in additional lending capital to meet the needs of lending activity in 2011, bringing total lending capital to \$34.4 million. The \$6.7 million in additional lending capital was made possible by a new investment from TD Bank, an increased investment from Bank of America and equity capital grants totaling \$3.65 million from NeighborWorks® America and the U.S. Treasury's CDFI Fund. We are appreciative of these investors' confidence in our lending performance.

Review of Financial Results for Fiscal Year 2011

NC's Statement of Financial Position for the year ended December 31, 2011 reflects continued growth generated from increasing lending volume, corresponding loan portfolio growth, additional debt financing, continued equity capital support from NeighborWorks® America and a strong net operating surplus for Fiscal Year 2011. For Fiscal Year 2011, total assets increased 19.9% over the prior year, while total liabilities and total net assets increased 16.5% and 22.4%, respectively over the previous fiscal year.

Condensed Statement of Financial Position			
	<u>FY 2011</u>	<u>FY 2010</u>	Total Percentage Change
<u>ASSETS</u>			
Cash, Cash Reserves and Cash Equivalents	\$5,936,243	\$5,087,121	16.69%
Loans Receivable (net of Allowance)	\$29,241,796	\$24,256,094	20.55%
Capital Assets (net)	\$63,348	\$28,986	118.55%
Other Assets	\$146,567	\$138,040	6.18%
Total Assets	\$35,387,954	\$29,510,241	19.92%
<u>LIABILITIES</u>			
Notes Payable	\$13,333,334	\$10,666,667	25.00%
Loan Participation Payable	\$728,387	\$1,628,064	-55.26%
Other Liabilities	\$360,637	\$89,442	303.21%
Total Liabilities	\$14,422,358	\$12,384,173	16.46%
<u>NET ASSETS</u>			
Unrestricted	\$2,317,610	\$662,217	249.98%
Temporarily Restricted	\$2,577,367	\$2,252,475	14.42%
Permanently Restricted	\$16,070,619	\$14,211,377	13.08%
Total Net Assets	\$20,965,596	\$17,126,069	22.42%

Assets

Cash and Cash equivalents

Cash, cash reserves and cash equivalents are comprised of operating cash, operating reserve, restricted cash, loan loss reserve and loan capital. Cash for operations and reserves increased by \$2.3 million (63.5%) resulting from the increase in loan loss reserves, interest reserves for borrowers and a positive operating surplus. Loan capital cash decreased \$142,344 (9.2%) from the prior fiscal year as the result of lending activities and the net of new and the repayment of debt loan capital. NC's working capital continues to strengthen with NC's current ratio of 6.84 for 2011, compared to 5.60 in 2010.

Loans Receivable (net)

Loans funded totaled \$15.5 million for 2011, an increase of 9.2% in lending volume over 2010. The increased lending volume, net of allocated loan loss reserves and repayments, resulted in NC's portfolio of outstanding loans to increase to \$29.2 million, a 20.6% increase over 2010 and setting a new high mark for the Organization.

Capital Assets

Capital assets (furniture, hardware, software and tenant improvements) increased by \$34,362 (118.6%) over 2010, net of disposals, and relates to the Organization's information

technology system infrastructure upgrade and the acquisition of a new loan management system application.

Other Assets

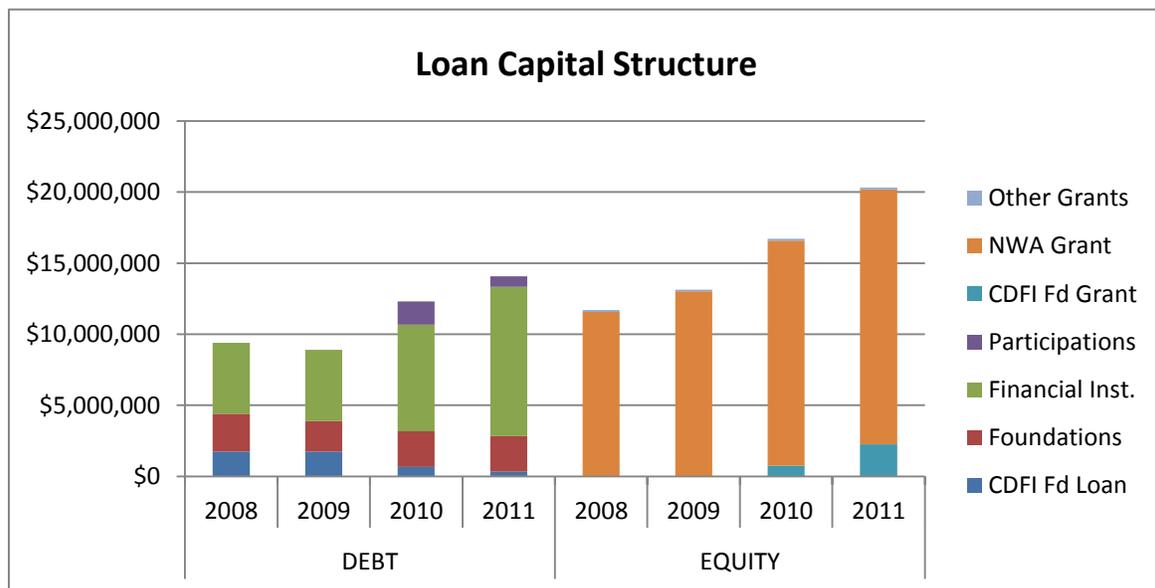
Other assets increased \$8,527 (6.2%) over 2010 as the result of an increase in prepaid costs that will be amortized over future months.

Liabilities

Notes Payable and Loan Participation Payable

In 2011, NC received new debt financing from two financial institutions, increasing debt financing by \$3.0 million to an overall total of \$14.0 million, net of repayments, an increase of 14.4% over Fiscal Year 2010. The current outstanding debt has an average maturity of 2.0 years, with individual maturities ranging from 8 months to 8 years.

NC’s overall loan capital consists of debt financing and capital grants from the CDFI Fund and NeighborWorks® America. Capital from NeighborWorks® America is in the form of Permanently Restricted Net Assets granted to the Organization through a Master Investment Agreement. Overall loan capital is comprised of 59% equity and 41% debt and has a combined total of \$34.4 million at the end of 2011.



Other Liabilities

Other liabilities increased 303% over the previous year, primarily due to the increase in deferred interest income held by NC compared to 2010.

Net Assets

Net Assets consist of three different categories; unrestricted, temporary restricted, and permanently restricted. Unrestricted net assets have no external conditions or restrictions. Temporary restricted net assets have restrictive conditions that need to be satisfied before these net assets may be used. Restrictive conditions pertain to purpose and time.

Permanently restricted net assets for NC are capital funds contributed by NeighborWorks® America to be used for funding loans or funding loan loss reserves.

Overall net assets increased \$3.8 million (22.4%) in Fiscal Year 2011, compared to Fiscal Year 2010. Major elements in this increase were \$2.15 million in permanently restricted capital contributions from NeighborWorks® America, a \$1.5 million Financial Award from the CDFI Fund and \$500,000 in temporary restricted expendable grants. NeighborWorks® America also provided NC with a \$350,000 expendable operational grant that contributed significantly to the \$349,665 net operating surplus for Fiscal Year 2011.

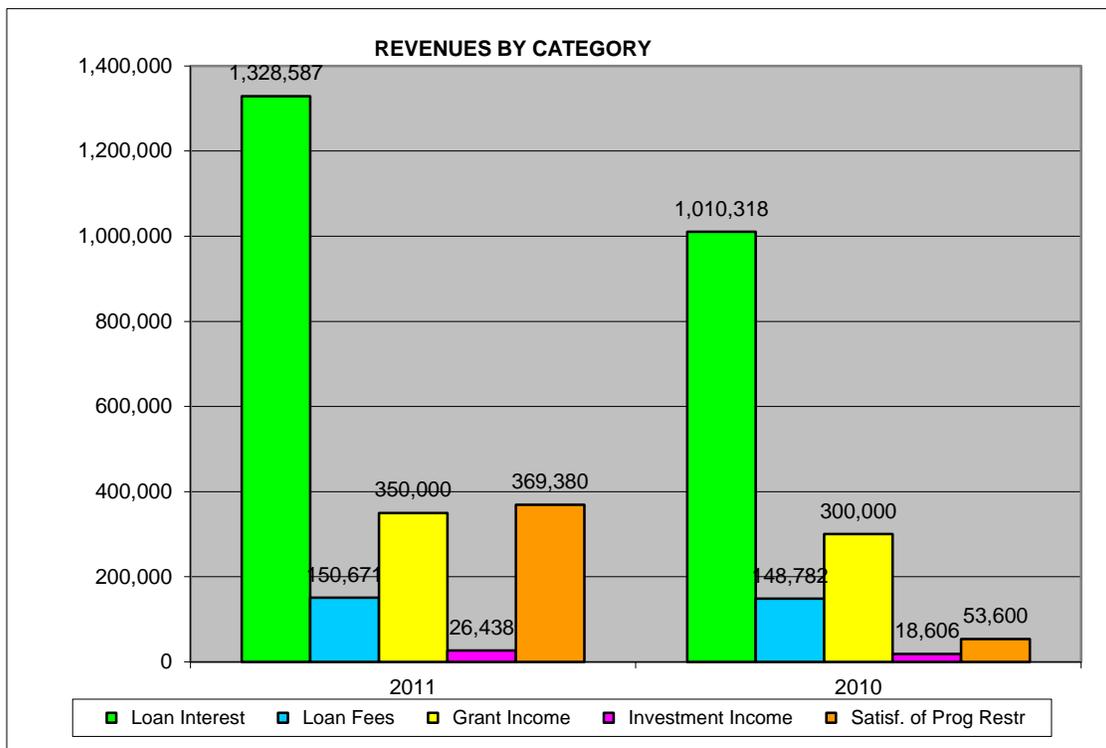
Fiscal Year 2011 Operations

NC achieved a net operating surplus of \$349,665 for Fiscal Year 2011 compared to a net operating surplus of \$102,678 for 2010. This is NC's second consecutive year of having a net operating surplus. The results for Fiscal Year 2011 yielded a self sustainability percentage of 97%, compared to a self sustainability percentage of 86% for Fiscal Year 2010.

FY 2011 and FY 2010 Operating Revenue and Expenses Comparison			
	2011	2010	Total Percentage Change
REVENUE			
Grant Income	350,000	300,000	16.67%
Loan Fees	150,671	148,782	1.27%
Loan Interest	1,328,587	1,010,318	31.50%
Investment Income	26,438	18,606	42.10%
Satisfaction of Program Restrictions	369,380	53,600	589.14%
Total Revenue	\$2,225,076	\$1,531,306	45.31%
EXPENSE			
Debt Service	505,808	427,891	18.21%
Grant Expense	283,800	50,000	467.60%
Personnel and Benefits	709,326	626,692	13.19%
Consulting/Professional	189,667	147,230	28.82%
Other Operating	186,810	176,815	5.65%
Total Expenses	\$ 1,875,411	\$ 1,428,628	31.27%
Net Operating Surplus (Deficit)	\$ 349,665	\$102,678	240.55%

Operating Revenues

For Fiscal Year 2011, NC's revenues totaled \$2.2 million, an increase of \$693,771 (45.3 %) over Fiscal Year 2010. Operating revenues for NC consist of the following: loan interest income, grant income, loan fees, investment income and satisfaction of program restrictions.



Earned income (comprised of loan interest income, loan fees and investment income) for 2011 increased by \$327,990 (27.9%) over 2010. As illustrated above, the largest category of revenue in 2011 was loan interest income with \$1.33 million compared to \$1.01 million in 2010, a 31.5% increase over the previous year. The increase is attributed to the continual growth of NC's loan portfolio, which grew 20.6% over last fiscal year.

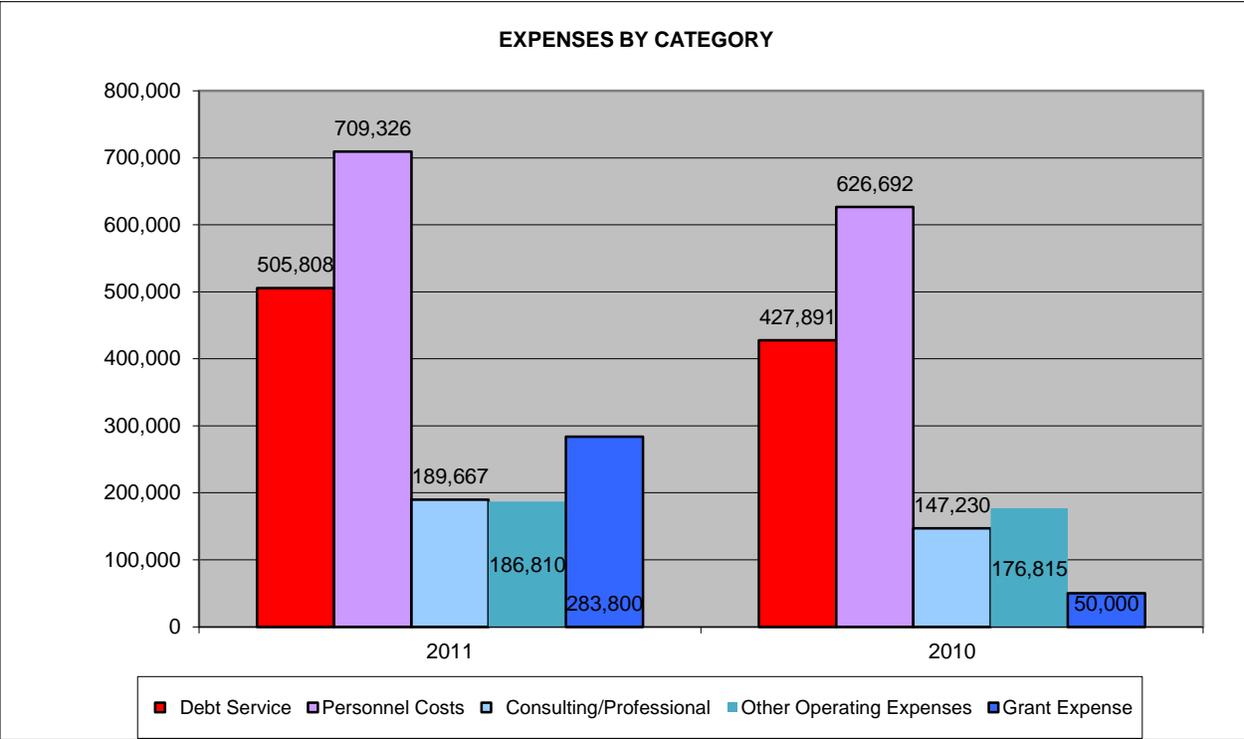
Grant Income accounted for \$350,000 in 2011, an increase of \$50,000 (16.67%) over 2010 and was the result of an operational grant from NeighborWorks® America. This income is excluded in the determination of the Organization's self sustainability percentage, which was 97% for 2011 and 86% for 2010.

Loan Fees from loan originations was \$150,671 in 2011, an increase of \$1,889 (1.3%) compared to 2010. This reflects the increased loan volume (9.2%) in 2011 over 2010.

Investment Income (interest) provided \$26,438 in revenues in 2011, a \$7,832 (42.1%) increase over last fiscal year. Management was successful in realigning treasury management activities to generate improved returns in 2011.

Operating Expenses

For the Fiscal Year 2011 NC's operating expenses increased \$446,783 (31.3%) to \$1.9 million, compared to \$1.4 million in 2010. NC's operating expenses are comprised of the following major categories: Debt Service, Personnel Costs, Consulting and Professional, and Other Operating Expenses.



Personnel Costs accounted for \$709,326 (38%) of NC’s operating expenses for 2011, compared to \$626,692 for 2010, an increase of \$82,634 (13.2%). Personnel Costs include the salaries for 5 FTE in 2011 and 6 FTE in 2010, as well as payroll taxes and benefit plans (disability, health, life and retirement) for the full time staff of NC. The Organization experienced staff turnover in non-management positions and periods of medical leave in other areas.

Debt service expense increased by \$77,917(18.2%) to \$505,808 for the fiscal year compared to \$427,891 for 2010. The Organization increased its borrowed capital by \$3.0 million during 2011 at an average interest rate of 3.25%.

Consulting and Professional expenses were \$189,667 (10%) in 2011, compared to \$147,230 in 2010 an increase of \$42,437 (28.8%). Expenses include audit fees, consulting services (accounting, business planning, loan underwriting, human resources and information technologies), and legal fees. Contributing to the increase in the expense for 2011 was the one-time information technology infrastructure upgrade that occurred during the year was completely offset by the CDFI technical assistance grant funds that are included in the Satisfaction of Program Restrictions revenue line.

Other Operating Expenses increased \$9,995 (5.7%) to \$186,810 for 2011, versus \$176,815 in 2010 and are comprised of expenses associated with general office expenses, marketing, corporate insurance, rent and utilities, marketing, and travel for business or organizational purposes.

Portfolio Risk Management

The management of NC is responsible for establishing and maintaining effective compliance and risk management for the NC loan portfolio. NC monitors compliance matters on an ongoing basis for all elements of its business and relations.

NC employs best practices from various areas ranging from the financial service industry, community banking, and community development financial institutions to mitigate risk. These practices include quarterly reporting from borrowers and performing annual reviews on outstanding loans. NC's portfolio risk management process also benefits from NC's collaboration with NeighborWorks® America to share information regarding member organizations. As the result of NC's risk management process, NC has achieved better than industry average results in the areas of interest delinquencies, write-offs and loan loss reserve rates.

As represented in the chart below, NC is required by investor covenant to maintain a loan loss reserve allowance of 6% of the outstanding loan portfolio. NC's strong underwriting of loans and portfolio management is making progress to make the overall loan portfolio risk rating come in below the investor covenant requirement. NC continues to experience a low amount of loan write-offs. In 2011, \$51,486 was written off as part of a loan restructuring. Inception to date, NC has had a 1.1% cumulative write-off rate on its cumulative loan activities, an extremely low percentage compare to industry averages.

Portfolio Management Information			
	2011	2010	2009
Total Loan Portfolio	\$31,108,294	\$25,883,320	\$16,075,255
Interest Delinquencies over 30 days	0%	0%	0%
Loan Loss Reserve Per Risk Rating	4.43%	6.29%	5.78%
Loan Loss Reserve Per Investor Covenants	6.00%	6.00%	N/A
Loan Write-offs	\$51,486	\$75,000	\$702,377
Loan Write-offs Percentage (of Total Loan Portfolio)	0.20%	0.30%	4.40%
Credit Quality – Adequate and Above	96%	93%	92%

Information Technology

NC completed upgrades to the Organization's internal information technology system during 2011 and is continuing to explore ways the new loan management system can be utilized to improved communication to NC's customer base and provide important data collection and reporting for the Organization. Additionally a redesigned company website was launched and includes additional info for customers and investors. These expenditures were funded by a technical assistance grant from the CDFI Fund.

Business Goals for Fiscal Year 2012

Looking forward to Fiscal Year 2012, NC's business plan includes the following goals:

- ⊙ Continue to increase NC's market share of NeighborWorks® America organizations by 9% as a result of greater outreach and strengthen business relationships.
- ⊙ Originate over \$27 million in new loans, an increase of 77% over 2011.
- ⊙ Increase loan capital by almost \$24 million to support the projected increase in lending volume.
- ⊙ Achieve a Self Sustainability Ratio of at least 100%.

NC has identified the following factors in the current business environment that will have an impact on the ability of NC to meet its business goals for Fiscal Year 2012:

- Funding vulnerability of federal affordable housing programs (HOME, CDBG, NSP, LIHTC) which are used by the majority of NC's customers as repayment sources for our loans.
- State and local budget deficits and their effect on additional housing subsidy sources often used for repayment of NC loans.
- Availability and terms of borrower construction and permanent financing for affordable housing and community revitalization projects.
- Customer's real estate development pipeline due to increased competition for available land and property, reduced real estate portfolio performance, organizational financial health, and stalled or compromised development projects.
- Availability and pricing of significant new investor capital.