



## 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, 2015. The intent of this discussion and analysis is to serve as an introduction to NeighborWorks® Capital Corporation's audited 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 audited financial statements.

### Background

NC 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 provide 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 maintains a strong and geographically diverse loan portfolio representing 24 states and the District of Columbia and utilizing the various flexible financing products available from the Organization. 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 31 months. The primary real estate type used for NC's loans is rental followed by for sale and commercial.

### Strong Balance Sheet

NC's Statement of Financial Position for the year ended December 31, 2015 shows continued strength as its net asset position continues to grow (\$32.8MM, 51% of assets) while new sources of contingent financing are added, along with continuing equity capital support from NeighborWorks® America.

Condensed Statement of Financial Position					
	2015		2014		%
	\$	%	\$	%	Change
<b>ASSETS</b>					
Cash, Cash Reserves and Equivalents	\$ 11,384,660		\$ 11,289,611		1%
Loans Receivable (net of Allowance)	\$ 52,715,386		\$ 56,369,018		-6%
Capital Assets (net)	\$ 19,143		\$ 24,164		-21%
Other Assets	\$ 266,014		\$ 855,063		-69%
<b>Total Assets</b>	<b>\$ 64,385,203</b>	<b>100%</b>	<b>\$ 68,537,856</b>	<b>100%</b>	<b>-6%</b>
<b>LIABILITIES</b>					
Notes Payable	\$ 30,314,000		\$ 37,488,045		-19%
Equity Equivalent Investments	\$ 1,000,000		\$ 1,000,000		0%
Other Liabilities	\$ 301,505		\$ 345,480		-13%
<b>Total Liabilities</b>	<b>\$ 31,615,505</b>	<b>49%</b>	<b>\$ 38,833,525</b>	<b>57%</b>	<b>-19%</b>
<b>NET ASSETS</b>					
Unrestricted	\$ 6,757,785		\$ 5,321,540		27%
Temporarily Restricted	\$ 2,479,191		\$ 2,812,034		-12%
Permanently Restricted	\$ 23,532,722		\$ 21,570,757		9%
<b>Total Net Assets</b>	<b>\$ 32,769,698</b>	<b>51%</b>	<b>\$ 29,704,331</b>	<b>43%</b>	<b>10%</b>

## **Assets**

### **Cash, Cash Reserves and Cash equivalents**

Cash, cash reserves and cash equivalents are comprised of operating cash, operating reserve, restricted cash for grants, loan loss reserve, and loan capital. Cash for operations and reserves increased by \$95K or 1% for the year ending December 31, 2015 as the result of the net operating surplus for FY 2015 and an increase in the cash for loan loss reserves during FY 2015. NC's current ratio at the end of 2015 is 3 to 1 which is comparable to 2014.

### **Loans Receivable (net)**

NC's loans receivable, net of loan loss reserves, decreased by 6% to \$52.7 million compared to \$56.4 million for 2013. This decrease was driven by \$24 million in disbursements, offset by \$26 million in loan repayments.

## **Liabilities**

### **Notes Payable and Equity Equivalent Investments**

As a result of the activity during Fiscal Year 2015, Notes Payable decreased by \$7.2 million (19%), net of debt draw downs and repayments, to an overall total of \$31.3 million. The current outstanding debt has an average remaining maturity of 3.5 years, with individual maturities ranging from 9 months to 12 years. NC has \$24.9 million in credit facilities available at year end 2015 for financing, compared to \$11.0 million in 2014.

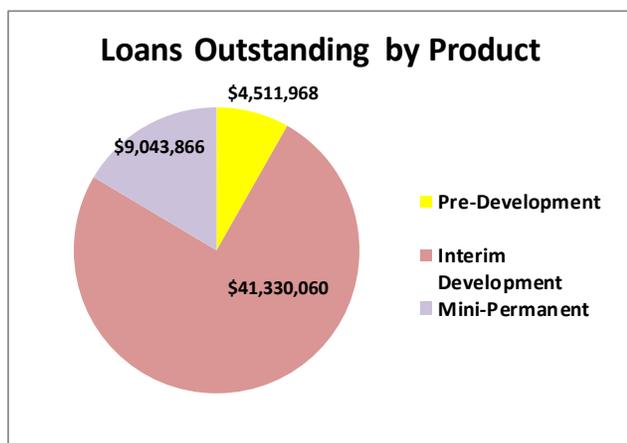
NC's overall loan capital consists of debt financing, equity equivalent investments and capital grants from the CDFI Fund, and NeighborWorks® America. Capital from NeighborWorks® America is in the form of permanently restricted net assets granted to the Organization through a Master Investment Agreement. Overall available loan capital is comprised of 37% equity and 63% debt (includes available undrawn credit facilities) and has a combined total of \$84.2 million from all equity and debt sources at the end of 2015.

## **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 \$3.1 million (10%) in Fiscal Year 2015, compared to Fiscal Year 2014. Unrestricted net assets increased \$1.4 million, primarily due the 2015 net operating surplus of \$1.0 million. Temporary and permanently restricted net assets increased by \$1.6 million as the result of \$2.2 million in permanently restricted capital grant from NeighborWorks® America, offset by \$0.6 million in net assets releases from restriction for lending capital and changes in the loan loss reserves. As of December 31, 2015, NC managed and serviced a total loan portfolio of \$68.0 million comprised of \$54.9 million of NC sourced capital and \$13.1 million in capital made available through loan participations with a series of regional and national CDFIs. NC will continue to use loan participations to diversify, manage and mitigate risk while fulfilling its mission and strategic goal to increase its impact on the communities served by NWOs.

## Loan Quality



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 while maintaining a robust loan loss reserve of 3.95%.

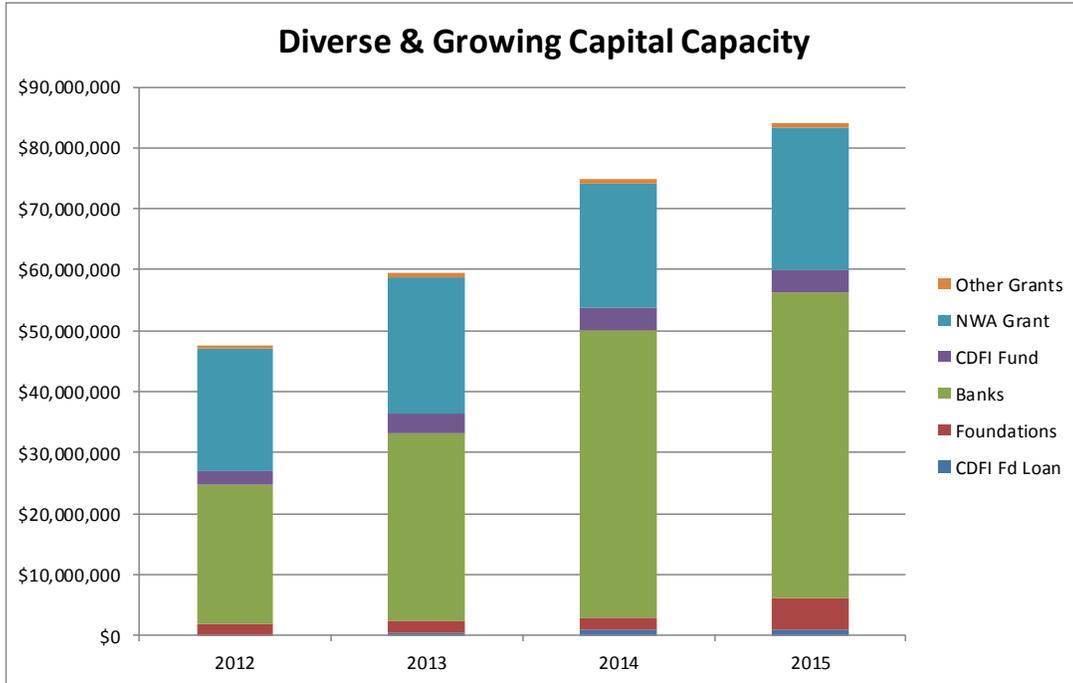
As represented in the chart below, NC is required by investor covenant to maintain a loan loss reserve allowance of 3.50% of the outstanding loan portfolio. The loan portfolio reserve belies NC's conservative risk rating process and our historical delinquency and write-offs are reflective of our diligent risk management techniques.

### Portfolio Management Information

	FY 2015	FY 2014	FY 2013	FY 2012
Total Loan Portfolio	\$ 54,885,894	\$ 58,413,490	\$ 36,644,903	\$ 30,366,586
Interest Delinquencies over 30 days	0%	0%	0%	0%
Loan Loss Reserve Per Risk Rating	3.95%	3.48%	4.07%	5.02%
Loan Loss Reserve Per Investor Covenants	3.50%	3.50%	6.00%	6.00%
Loan Write-Offs (net of recoveries)	\$ -	\$ 450,000	\$ 396,887	\$ -
Loan Write-Offs % (Total of Loan Port.)	0.00%	0.77%	1.08%	0.00%
Credit Quality - Adequate and Above	97%	99%	96%	92%

## Expanded Lending Capacity

NC was able to secure \$13 million in additional lending capital to meet the needs of lending activity during 2015, bringing NC's total available lending capital to \$84.2 million up 12% from 2014. The \$13 million in additional lending capital was a combination of \$11.1 million in debt investments and a \$2.1 million in an equity capital grant from NeighborWorks® America.



## Fiscal Year 2015 Operations

NC recorded a net operating surplus of \$958,973 for 2015, a 17% increase over 2014's net operating surplus of \$819,337.

This is NC's sixth consecutive year of net operating surpluses. The 2015 results yielded a self sustainability percentage of 130%, compared to a self sustainability percentage of 129% for 2014.

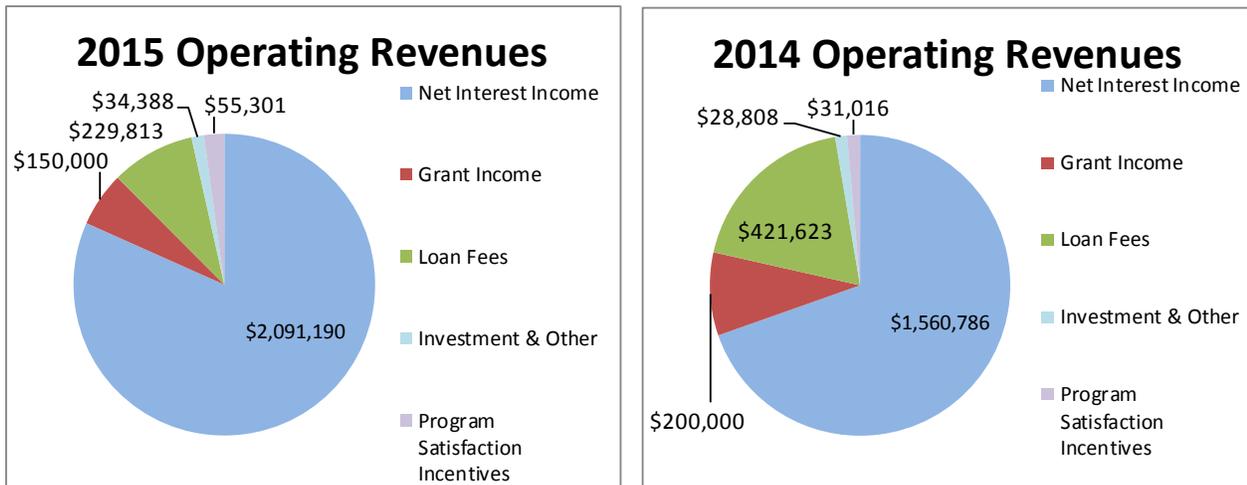
### Operating Income Statement: FY 2015 v FY 2014

	<u>2015</u>	<u>2014</u>	<u>% Change</u>
<b>REVENUE</b>			
Loan Interest	3,178,084	2,304,721	38%
Debt Service Expense (COF)	<u>1,086,894</u>	<u>743,935</u>	<u>46%</u>
<b>Net Interest Income</b>	<b><u>2,091,190</u></b>	<b><u>1,560,786</u></b>	<b><u>34%</u></b>
Grant Income	150,000	200,000	-25%
Loan Fees	229,813	421,623	-45%
Investment Income and Other Fees	34,388	28,808	19%
Satisfaction of Program Restrictions	<u>55,301</u>	<u>31,016</u>	<u>78%</u>
<b>Total Fee &amp; Grant Income</b>	<b><u>469,502</u></b>	<b><u>681,447</u></b>	<b><u>-31%</u></b>
<b>Total Revenue</b>	<b><u>2,560,692</u></b>	<b><u>2,242,233</u></b>	<b><u>14%</u></b>
<b>EXPENSE</b>			
Grant Expense	34,301	31,016	11%
Personnel & Benefits	1,005,775	934,105	8%
Consulting / Professional	156,841	162,047	-3%
Other Operating	<u>404,802</u>	<u>295,728</u>	<u>37%</u>
<b>Total Expenses</b>	<b><u>1,601,719</u></b>	<b><u>1,422,896</u></b>	<b><u>13%</u></b>
<b>Net Operating Surplus (Deficit)*</b>	<b><u>958,973</u></b>	<b><u>819,337</u></b>	<b><u>17%</u></b>

*\*Excludes provision for loan loss as well as Temp/Perm restricted grants.*

## Operating Revenues

For Fiscal Year 2015, NC's net operating revenues totaled almost \$2.6 million, an increase of 14% over Fiscal Year 2014. Operating revenues for NC consist of the following: net (loan) interest income, grant income, loan fees, investment income, other fees and satisfaction of program restrictions.



As illustrated above, the largest category of revenue in 2015 was loan net interest income with \$2.1 million compared to \$1.6 million in 2014, a 34% increase over the previous year. While year end 2015 loans outstanding are lower than year end 2014, the average loans outstanding were larger for 2015 driven by an influx of lending activity in 4Q14.

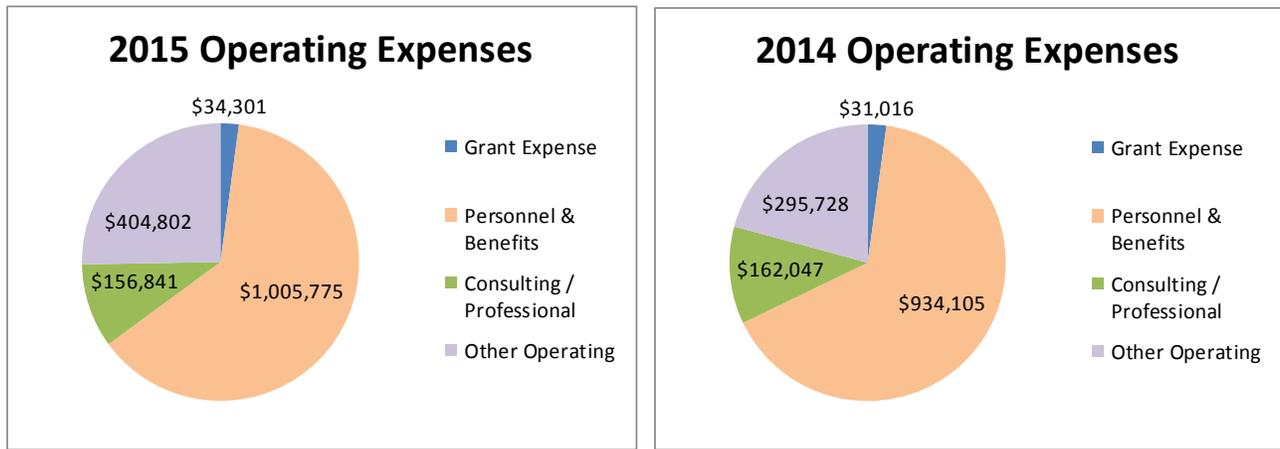
Interest Income for FY 2015 was \$3.2 Million up \$0.9 Million or 38% from 2014. NC's loan portfolio had an average loan rate of 5.43% at year end, compared to 5.48% at the end of 2014. Debt service expense increased by \$0.3 Million (46%) to \$1.1 Million in 2015. The increase in 2015 is again here a result of average loans outstanding being larger in 2015 than 2014.

Loan Fees from loan originations were \$229,813 in 2015, a decrease of (\$191,810) (45%) compared to 2014 and is reflective of the decline in originating activity for 2015.

Grant Income accounted for \$150,000 in 2015, a decrease of (\$50,000) or (25%) from 2014 from NeighborWorks® America. This income is excluded in the determination of the Organization's self sustainability percentage, which was 130% for 2015 and 129% for 2014.

## Operating Expenses

For the Fiscal Year 2015 NC's operating expenses increased by \$178,823 (13%) to \$1.6 million, compared to \$1.4 million in 2014. NC's operating expenses are comprised of the following major categories: Personnel Costs, Consulting and Professional, Grant Expense and Other Operating Expenses.



Personnel Costs accounted for \$1,005,775 of NC's operating expenses for 2015, compared to \$934,105 for 2014, an increase of \$71,670 (8%). Personnel Costs include the salaries for 7 FTE as well as related payroll taxes and benefit plans (disability, health, life and retirement).

Consulting and Professional expenses were \$156,841 in 2015, compared to \$162,047 in 2014 a decrease of \$5,206 (3%). These expenses include audit fees, consulting services (business planning, loan underwriting, human resources and information technologies), and legal fees.

Other Operating Expenses increased 37% to \$404,802 for 2015, versus \$295,728 in 2014 and are comprised of expenses associated with loan service fees, general office expenses, marketing, corporate insurance, rent and utilities, marketing, and travel for business or organizational purposes. The majority of the increase is associated with higher expenses for travel (remote employees), marketing, office operational expenses and amortization/depreciation compared to Fiscal Year 2014.

## Strategic Plan

In 2013, the Board of Directors of NC adopted a 2014-2018 Strategic Plan to provide guidance towards the achievement of long-term organizational goals. The five-year plan establishes five strategic goals.

- ♥ *Triple NeighborWorks Capital cumulative lending volume to \$350 million while maintaining strong loan quality.*
- ♥ *Double NeighborWorks Capital on-balance sheet capital to \$100 million through leverage and diversification of capital sources, and leverage an additional \$30 million in off-balance sheet capital.*
- ♥ *Increase NeighborWorks Capital impact on the communities served by NeighborWorks America organizations*
- ♥ *Advocate on behalf of CDFIs and the communities we serve. Further develop thought leadership within NeighborWorks America about the role of capital in improving low-income communities and their residents.*
- ♥ *Grow and strengthen the Organization to implement this plan*

## FY 2015 Business Goals Results

In 2015 NeighborWorks® Capital achieved the following:

- ✔ Raised \$13 million in new lending capital
- ✔ Increased net assets by 10%
- ✔ Increased operating sustainability from 129% to 130%
- ✔ Originated \$35 million in loans
- ✔ Lending generated the production and preservation of 1,636 rental and 48 for-sale housing units and over 61,000 square feet of commercial space
- ✔ 97% of loans assisted housing projects for individuals and families earning below 80% of area median income

Please read more about our results in our 2015 Annual Report on the Publications page of our website for additional information on 2015 activities and performance.

With these strategic goals providing guidance and direction, NC's staff has outlined the following Business Goals for FY 2016.

## Business Goals for Fiscal Year 2016

Looking forward to 2016, NC's business plan includes the following goals:

- ⊙ Originate \$51.5 million in new loans, with \$6.5 million through loan participations, an increase of 46% over 2015.
- ⊙ Increase lending capital by \$7.7 million to support the projected increase in lending volume.
- ⊙ Increase NC's market share of NeighborWorks® America organizations by 5% with continued marketing, outreach and expansion of business relationships in the CDFI industry.
- ⊙ Achieve a Self Sustainability Ratio of at least 119%.