



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, 2010. 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.

Executive Summary

NeighborWorks[®] Capital is a national community development loan fund based in Silver Spring, MD serving NeighborWorks America affiliates (NWOs) in all 50 states and 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 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 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.

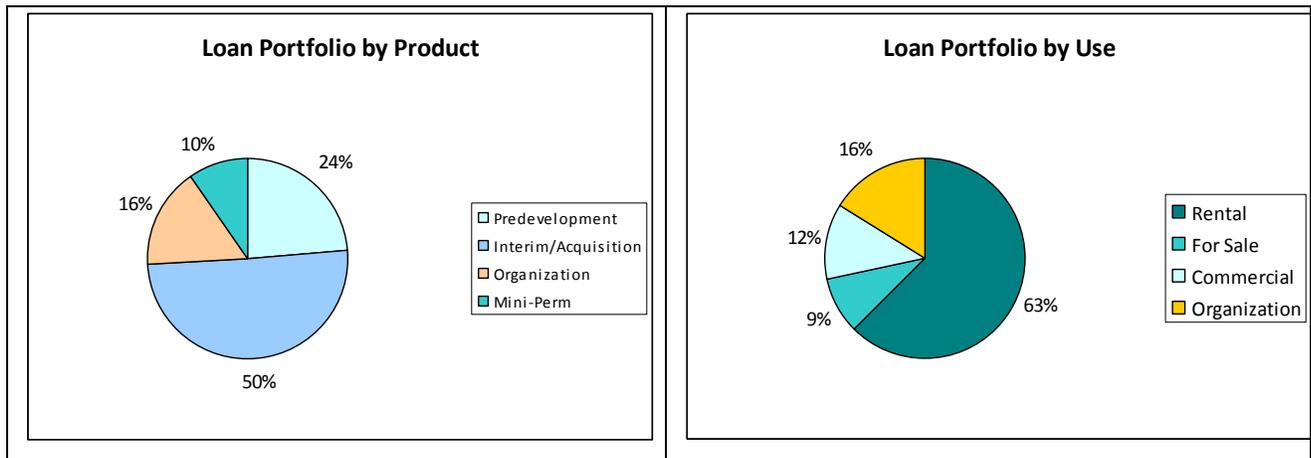
In 2010 NeighborWorks Capital successfully met the following goals in its Business Plan set by the board of directors:

- Exceeded our lending goals by 5%
- Introduced four new Mini-Perm loan products to assist NWOs with existing rental portfolios
- Increased our market share of NWO customers by 13%.
- Raised \$8.1 million in new lending capital in a transitioning capital market
- Expanded our partnerships with other community development lenders to assemble \$7 million in partner capital for our customer's projects
- Increased net assets by 29%

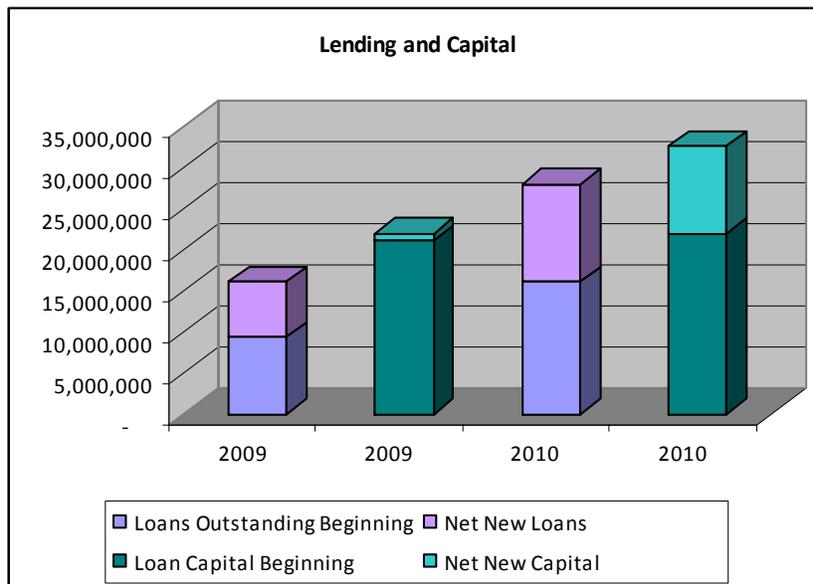
In 2010 NC had the highest lending activity in its history:

- ⊙ Originating \$16.7 million in loans, leveraging \$263 million in permanent financing (16:1 leverage)
- ⊙ Lending to 17 projects for 1,168 rental and for-sale housing units, of which 91% were affordable to individuals earning below 80% of area median income
- ⊙ Closing our first two Mini-Perm loans for solar panels for a mixed-use project and for acquisition of a 125 unit high-rise rental project and repairs to reduce utility costs

NC has a 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 building for development and renovation with an average maturity date of 27 months. The primary real estate type used for NC's loans is rental followed by commercial and for sale property.



To meet increased lending activity in 2010 NC has raised \$8.1 million in additional capital, to a total of almost \$29 million. Contributing to that growth included a new investment from Bank of America and additional investment from Calvert Foundation. Also NeighborWorks America and the CDFI Fund provided equity grants of \$3.65 million. We are appreciative of these investors confidence in our lending performance.



The outstanding loan portfolio equaled \$25.68 million and remains strong in contrast to the general real estate market conditions and project subsidy environment. We have extended some loans due to delays in project take-out financing but have not experienced any delinquencies. Also, one loan was written-off equal to 0.1% of the outstanding portfolio.

Review of Financial Results for Fiscal Year 2010

NC's Statement of Financial Position grew substantially over 2009 as the result of increased lending volume, acquiring new sources of debt financing, continued equity capital support from NeighborWorks America and achieving a net operating surplus for Fiscal Year 2010. For Fiscal Year 2010, total assets increased 30.8% over the prior year, while total liabilities and total net assets increased 38.6% and 25.7%, respectively over the previous fiscal year.

Condensed Statement of Financial Position

	<u>2010</u>	<u>2009</u>	Total Percentage Change
ASSETS			
Cash, reserves and cash equivalents	\$5,087,121	\$7,296,242	-30.28%
Loans Receivable (net of reserve)	24,256,094	15,146,373	60.14%
Capital Assets (net)	28,986	32,670	-11.28%
Other Assets	138,040	85,033	62.34%
Total Assets	29,510,242	22,560,318	30.81%
LIABILITIES			
Notes Payable	12,294,731	8,900,000	38.14%
Other Liabilities	89,442	37,036	141.50%
Total Liabilities	12,384,173	8,937,036	38.57%
NET ASSETS			
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Unrestricted	662,217	507,883	30.39%
Temporarily Restricted	2,252,475	1,028,931	118.91%
Permanently Restricted	14,211,377	12,086,468	17.58%
Total Net Assets	17,126,069	13,623,282	25.71%

Assets

Cash and Cash equivalents

Cash and cash equivalents are comprised of operating cash, operating reserve, loan loss reserve and loan capital. Cash for operations and reserves increased by 57% (\$1.15 million) while cash for lending decreased 69% from the prior fiscal year and is primarily attributed to the deployment of loan capital in new loans and repayments on notes payable. Overall, working capital improved over last year, as evident by NC's current ratio of 5.60 for 2010, compared to 4.79 in 2009.

Loans Receivable

Lending volume for loans closed and funded totaled \$14.2 million for 2010, an increase of 31% over 2009. The increased lending volume, net of allocated loan loss reserves and

repayments, allowed NC's portfolio of outstanding loans to increase to \$24.3 million, a 60% increase over 2009 and resulting in the largest loan portfolio in NC's history.

Capital Assets

Capital assets (furniture, hardware, software and tenant improvements) decreased by 11.3% from the previous year primarily due to the removal of fully amortized and fully depreciated office equipment.

Other Assets

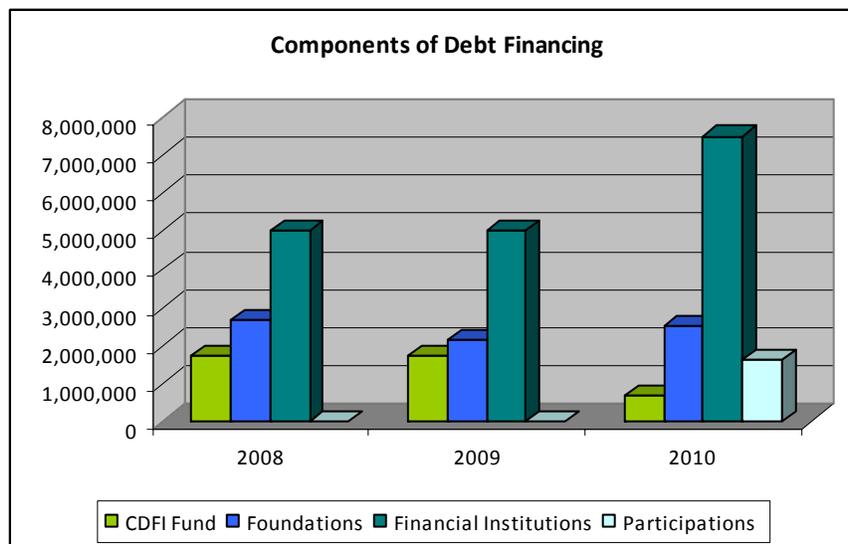
Other assets increased 62.3% over 2009 as the result of higher interest receivable associated with a larger loan receivable, and an increase in prepaid costs that will be amortized over future months.

Liabilities

Notes Payable

During Fiscal Year 2010, NC gained new investments from a financial institution, a foundation and financing from several CDFIs as participations in NC's new loan originations. The new debt financing increased by \$4.5 million, bringing overall outstanding debt to \$12.3 million, a 38% increase over the previous year's outstanding debt of \$8.9 million (net of repayments). The current outstanding debt has an average maturity of 2.2 years.

NC's loan capital consists of debt described in the previous paragraph as well as Permanently Restricted Net Assets granted to the organization from NeighborWorks America through a Master Investment Agreement. This agreement allows these capital grants to be used for both lending capital and to fund any loan write-offs. Capital is comprised of 61% equity and 39% debt at end of 2010, far higher than most CDFIs. This combined debt and equity totals \$27.28 million and has a blended cost of capital below 200 basis points.



Other Liabilities

Other liabilities increased 141.5% over the previous year, primarily due to the increase in deferred interest income held by NC and an increase in accrued interest payable as the result of NC's higher level of debt financing compared to 2009.

Net Assets

Net Assets of NC consist of three different classes; 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 26% in Fiscal Year 2010, compared to Fiscal Year 2009. Major elements in this increase were \$2.9 million in permanently restricted capital contributions from NeighborWorks America, a \$750,000 Financial Award from the CDFI Fund and \$578,000 in temporary restricted expendable grants,. NeighborWorks America also provided NC with a \$300,000 expendable operational grant that contributed to the \$102,675 net operating surplus for Fiscal Year 2010.

Fiscal Year 2010 Operations

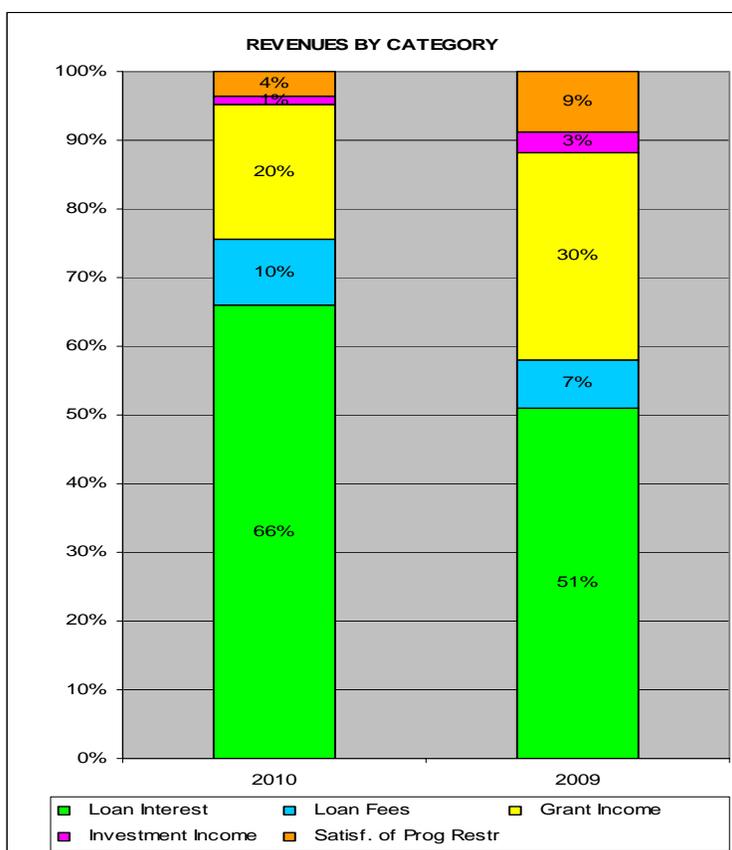
NC achieved a net operating surplus of \$102,675 for Fiscal Year 2010 compared to a net deficit of \$(232,186) for 2009. The results for Fiscal Year 2010 yielded a self sustainability percentage of 86%, even after the reduction in operational grant assistance from NeighborWorks America for Fiscal Year 2010.

FY 2010 and FY 2009 Operating Revenue and Expenses Comparison

	2010	2009	Total Percentage Change
REVENUE			
Grant Income	300,000	350,000	-14.29%
Loan Fees	148,782	80,375	85.11%
Loan Interest	1,010,318	593,323	70.28%
Investment Income	18,606	34,359	-45.85%
Satisfaction of Program Restrictions	53,600	103,075	-48.00%
Total Revenue	\$1,531,306	\$1,161,132	31.88%
EXPENSE			
Debt Service	427,891	298,724	43.24%
Personnel and Benefits	626,692	612,330	2.35%
Consulting/Professional	148,643	258,702	-42.54%
Other Operating	225,405	223,562	0.82%
Total Expenses	\$ 1,428,631	\$ 1,393,319	2.53%
NET Operating Surplus/(Deficit)	\$ 102,675	\$ (232,187)	144.22%

Operating Revenues

For Fiscal Year 2010, NC's revenues totaled \$1.53 million, a 31.9 % increase over \$1.16 million in 2009. 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 2010 equaled 77% of revenues, compared to 61% for the previous fiscal year. As illustrated above, the largest category of revenue was loan interest income and resulted in \$1.01 million (66%) of revenues for 2010, compared to \$593,323 (51%) in 2009. The increase in loan interest income is reflective of a substantial increase in lending activity in 2010.

Grant Income accounted for \$300,000 (20%) in revenue for Fiscal Year 2010, compared to \$350,000 (30%) and was the result of an operational grant from NeighborWorks America.

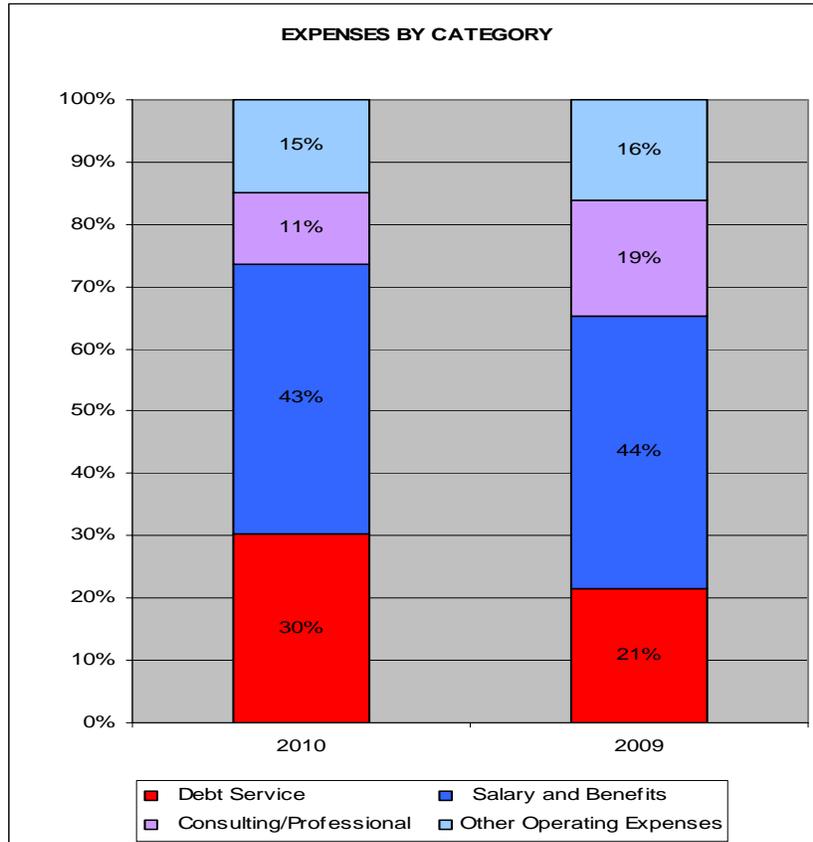
Loan Fees from origination accounted for \$148,782 (10%) in revenue for the year, compared to \$80,375 (7%) in 2009 and reflects the increase in lending volume during the fiscal year.

Investment Income (interest) accounted for \$18,606 (1%) in revenue for the fiscal year. This revenue source continues to be challenging in the current interest rate depressed environment. Management is reviewing its investment options to gain improved returns in 2011.

Operating Expenses

For the Fiscal Year 2010 NC's operating expenses only increased 3% to \$1.43 million, compared to \$1.39 million in 2009. NC's operating expenses are comprised of the following major categories: Debt Service, Personnel Costs, Consulting and Professional, and Other Operating

Expenses. The chart below reflects the proportion of each expense to overall expenses and a comparison to last year.



Personnel Costs accounted for \$626,692 (43%) of NC's operating expenses for 2010, compared to \$612,330 (44%) for 2009. Personnel Costs include the salaries for 6 FTE in 2010 and 5 FTE in 2009 and payroll taxes and benefit plans (disability, health, life and retirement) for the full time staff of NC. During 2010 the Organization experienced fluctuations in the number of full time staff personnel as the result of various types of leave and position transitions.

Debt service increased by 43% to \$427,891, equal to 30% of NC's operating expenses for 2010, compared to \$298,724 (21%) for 2009. NC raised \$4.5 million in debt financing at an average rate of 4.14%, with the overall debt with an average rate of 3.84%.

Consulting and Professional expenses were reduced by 42% to \$148,643 (11%) in 2010, compared to \$258,702 (19%) in 2009. Expenses include audit fees, consulting services (accounting, business planning, loan underwriting, human resources and information technologies), and legal fees. Contributing to the lower expenses for 2010 compared to 2009 was NC's reduced reliance for loan underwriting consulting due to the hiring of a Senior Loan Officer in 2010 and lower than anticipated need for legal services.

Other Operating Expenses were \$225,405 (15%) for 2010, versus \$223,562 (16%) in 2009 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.

Portfolio Management Information		
	FY 2010	FY 2009
Total Loan Portfolio	\$ 25,683,320	\$ 16,075,255
Deployment Ratio	89%	73%
Interest Delinquencies over 30 days	0%	0%
Loan Loss Reserve Rate	5.90%	5.78%
Loan Write-off Amount	\$ 75,000	\$ 702,377
Loan Write-off Percent	.03%	4.4%
Credit Quality Rating – Adequate and Above	93%	92%

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, charge-offs and loan loss reserve rates. The loan write offs in 2010 and 2009 were associated with legacy loans from an organization that was merged with NC at the end of 2007. The credit quality of NC's loan portfolio continues to improve as the result of strong underwriting and due diligence.

Information Technology

NC is currently in the process of evaluating upgrades to the Organization's information technology and management information systems. The management information system upgrades are associated with loan management system that would allow NC to be more responsive to customers and grow the NC's customer base. NC received a technical assistance grant from the CDFI Fund in 2009 that will used to implement the new loan management system and website.

Goals for Fiscal Year 2011

Looking forward to Fiscal Year 2011, NC's business plan includes the following goals:

- ⊙ Continue to increase NC's market share of NeighborWorks America organizations by 13% as a result of greater outreach and strengthen business relationships.
- ⊙ Research, design and test feasibility of a Development Line of Credit.
- ⊙ Originate over \$16,000,000 in new loans, an increase of 14% over 2010.
- ⊙ Increase loan capital by \$11 million to support the increase in lending volume, bring total loan capital to \$39 million by the end of the fiscal year
- ⊙ Achieve a Self Sustainability Ratio of 94%.

NC has identified the following factors in the current business environment that will have an impact on the ability of NC to meet the goals for Fiscal Year 2011;

- Funding vulnerability of federal affordable housing programs (HOME, CDBG, NSP) which are used by NC's customers as repayment sources for our loans.
- State and local budget crises and the effect on additional housing subsidy sources often used for repayment of NC loans.
- Availability and terms of borrower financing for affordable housing and community revitalization projects.
- Availability and pricing of new investor capital.
- Impact of NWOs real estate development pipeline from reduced real estate portfolio performance, organizational financial health, and stalled or compromised development projects.
- The state of the overall real estate market.