



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, 2013. 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

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 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 does not offer permanent financing as this is typically available locally and nationally by financial institutions.

Vision and Mission Statements

During 2013, the Organization established a strategic plan for the next five years, 2014-2018. As the result of the strategic planning process, the Organization developed a vision statement and a revised mission statement that is presented below. A dedicated section for the 2014-2018 Strategic Plan is presented later in this document.

Vision Statement

America is a nation of vibrant and diverse communities where everyone is proud to have a place to call home.

Mission Statement

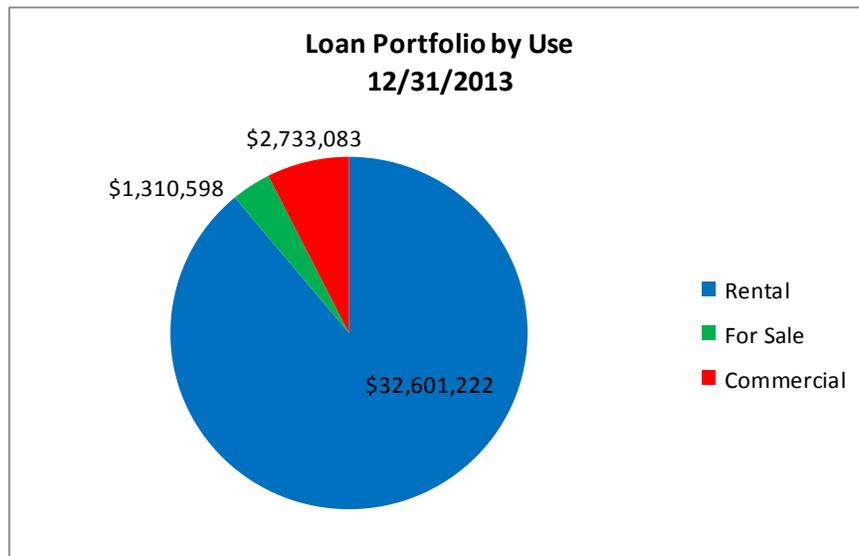
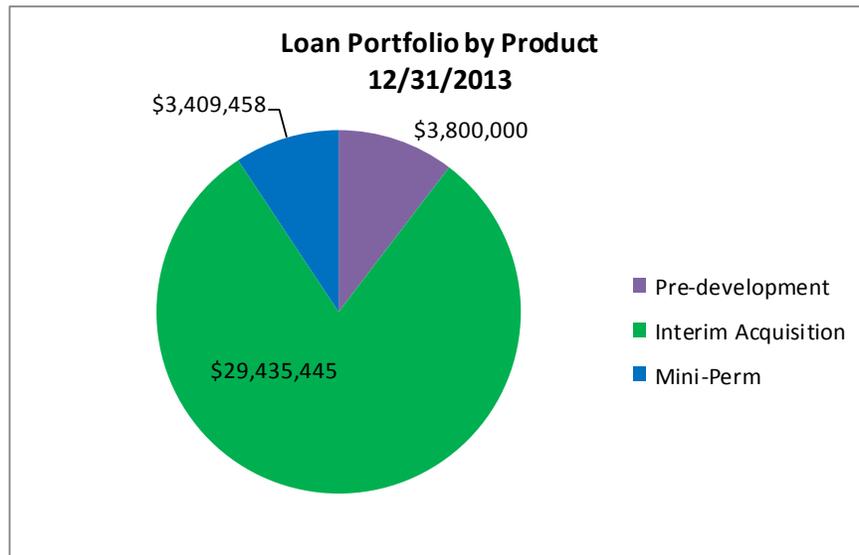
NeighborWorks Capital delivers the flexible capital needed by NeighborWorks America affiliates to provide affordable homes and strengthen communities.

Annual Business Goals

In 2013 NeighborWorks® Capital achieved the following:

- ☑ Increased NC's lending volume by 72% compared to 2012
- ☑ Raised \$12 million in new lending capital
- ☑ Increased net assets by 12%
- ☑ Increased operating sustainability of 112%
- ☑ Increased NC's market share by 11% with 11 new customers
- ☑ Originated \$28.5 million in loans, leveraging \$280 million in construction or permanent financing (10:1 leverage)
- ☑ Lending to 25 projects for 1,000 rental and for-sale housing units, of which 95% were affordable to individuals earning below 80% of area median income

NC maintains a strong and geographically diverse loan portfolio that utilized the various loan 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 22.5 months. The primary real estate type used for NC's loans is rental followed by commercial and for sale.



NC was able to secure \$12 million in additional lending capital to meet the needs of lending activity during 2013, bringing NC's total available lending capital to \$59 million. The \$12 million in additional lending capital was a combination of \$8 million in debt investments, \$2.2 million in an equity capital grant from NeighborWorks® America and a \$1.4 million award from the CDFI Fund in the form of equity grant and debt. The \$8 million in new debt was comprised of new investments from BB&T Bank and Capital One, along with an increased and renewed investment on an existing credit facility from Bank of America. The \$1.4 million award from the CDFI Fund required matching funds to be provided, which the Organization was able to do appropriately. We greatly appreciate the support all of our investors provide to our lending activities.

Review of Financial Results for Fiscal Year 2013

NC's Statement of Financial Position for the year ended December 31, 2013 shows continued growth as its loan portfolio increases while new sources of debt financing are added, along with continuing equity capital support from NeighborWorks® America. A net operating surplus for Fiscal Year 2013 adds to the increase in net assets for the fiscal year.

For Fiscal Year 2013, total assets increased 22.7% over the prior year, while total liabilities and total net assets increased 40.1% and 12.1%, respectively over the previous fiscal year.

Condensed Statement of Financial Position				
		<u>2013</u>	<u>2012</u>	Total Percentage Change
ASSETS				
Cash, Cash Reserves and Cash Equivalents		\$11,028,151	\$9,155,674	20.45%
Loans Receivable (net of Allowance)		\$34,446,208	\$28,544,591	20.68%
Capital Assets (net)		\$21,505	\$42,639	-49.56%
Other Assets		\$1,046,928	\$180,090	481.34%
	Total Assets	\$46,542,792	\$37,922,994	22.73%
LIABILITIES				
Notes Payable		\$18,750,000	\$13,000,000	44.23%
Equity Equivalent Investments		\$1,000,000	\$1,000,000	nc
Other Liabilities		\$334,581	\$328,728	1.78%
	Total Liabilities	\$20,084,581	\$14,328,728	40.17%
NET ASSETS				
Unrestricted		\$3,439,026	\$3,212,149	7.06%
Temporarily Restricted		\$3,252,650	\$2,016,995	61.26%
Permanently Restricted		\$19,766,535	\$18,365,122	7.63%
	Total Net Assets	\$26,458,211	\$23,594,266	12.14%

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 decreased by \$477,200 (-10.7%) primarily due to the reduction in cash for loan loss reserve as the result of changing the methodology in calculating the required loan loss reserve amount that was approved by NC's Board during 2013. Loan capital cash increased by \$2.3 million (50.1%) over 2012 due to loan repayment activity and slower loan disbursements in the fourth quarter of 2013. NC's

working capital continues to be strong as of the end of 2013, reflecting low Current Liabilities resulting in a current ratio of 64 to 1, compared to 69 to 1 in 2012.

Loans Receivable (net)

NC disbursed \$20.9 million in loans during 2013, compared to \$8.7 million in 2012. This led to an increase in the Organization’s outstanding loans, net of loan loss reserves for 2013 compared 2012, \$34.4 million and \$28.5 million, respectively. For the year end 2013, NC had \$10.3 million in loan commitments outstanding, compared to \$5.7 million in loan commitments at 2012 year end.

Capital Assets

Capital assets (furniture, hardware, software and tenant improvements) decreased by \$21,134(-49.5%) versus 2012, net of disposals, as the result of amortization and depreciation.

Other Assets

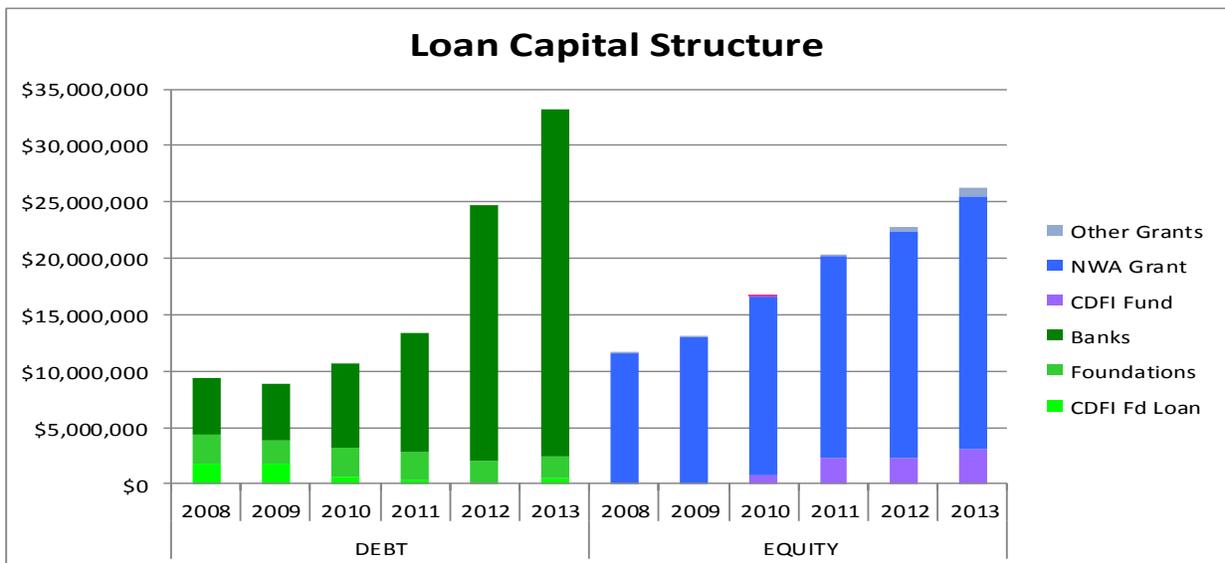
Other assets increased \$866,838 (481.3%) over 2012. The large increase over prior year is primarily related to a grant receivable from the CDFI Fund for the 2013 CDFI Fund award.

Liabilities

Notes Payable and Equity Equivalent Investments

In 2013, NC secured \$8 million in new debt facilities. As a result of activity during Fiscal Year 2013, Notes Payable increased by \$5.75 million (44.2%), net of debt draw downs and repayments, to an overall total of \$18.75 million. The current outstanding debt and equity equivalent investment has an average maturity of 4.1 years, with individual maturities ranging from 17 months to 10 years. NC has \$13 million in lines of credit available at year end 2013 for financing, compared to \$10.75 million in 2012.

NC’s overall loan capital consists of debt financing, equity equivalent investments and capital grants from the CDFI Fund, financial institutions 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 44% equity and 56% debt and has a combined total of \$59.4 million from all sources at the end of 2013.



Other Liabilities

Other liabilities increased slightly by 1.8% over the previous year, primarily due to changes in accrued liabilities.

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 \$2.9 million (12.1%) in Fiscal Year 2013, compared to Fiscal Year 2012. The majority of the increase was from \$2.2 million in permanently restricted capital contributions from NeighborWorks® America.

Fiscal Year 2013 Operations

NC recorded a net operating surplus of \$403,329 for 2013, a 25% decrease from 2012's net operating surplus of \$537,536. The decrease in net operating surplus from the prior year is primarily related to the planned reduction in the operational grant from NeighborWorks® America in FY 2013, \$175,000 compared to \$250,000 in FY 2012, and the overall increase in operating expenses in FY 2013 compared to FY 2012, excluding the impact of the pass through grant expense.

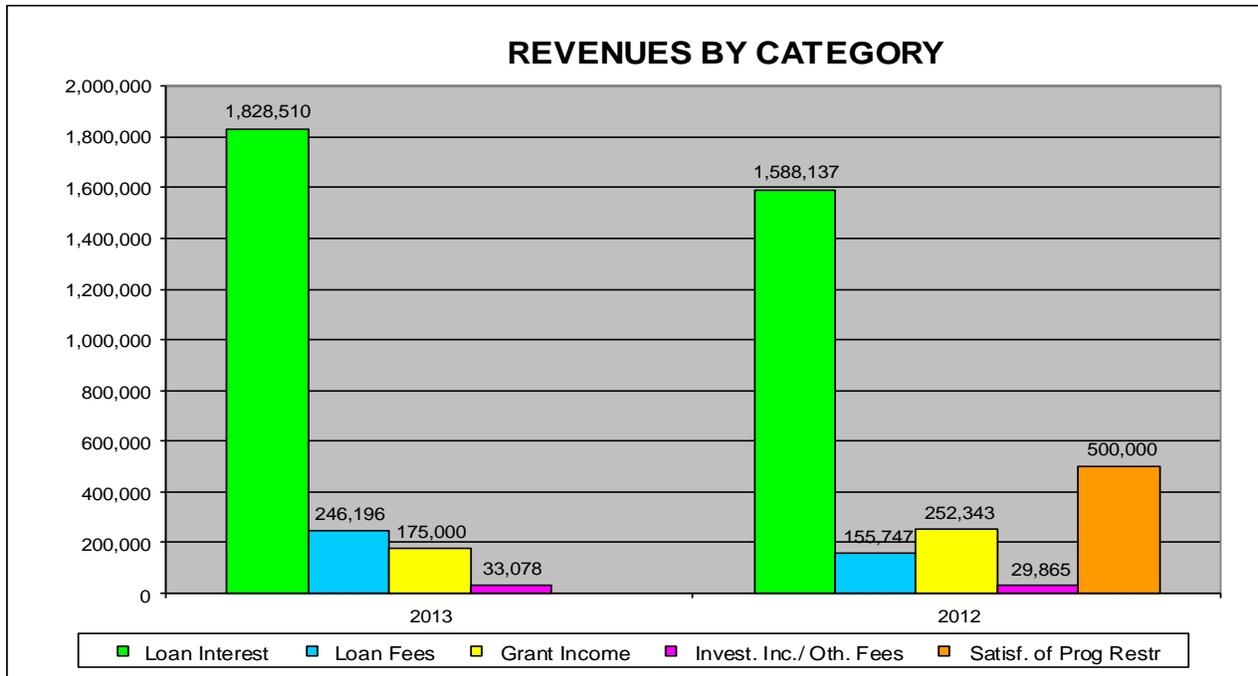
This is NC's fourth consecutive year of net operating surpluses. The 2013 results yielded a self sustainability percentage of 112%, compared to a self sustainability percentage of 114% for 2012.

FY 2013 and FY 2012 Operating Revenue and Expense Comparison					
					Total Percentage Change
	2013	2012			
REVENUE					
Grant Income	175,000	252,343			-30.65%
Loan Fees	246,196	155,747			58.07%
Loan Interest	1,828,510	1,588,137			15.14%
Investment Income and Other Fees	33,078	29,865			10.76%
Satisfaction of Program Restrictions	0	500,000	**		-100.00%
Total Revenue	\$2,282,784	\$2,526,092			-9.63%
EXPENSE					
Debt Service	603,253	472,517			27.67%
Grant Expense	0	500,000	**		-100.00%
Personnel and Benefits	773,883	625,346			23.75%
Consulting/Professional	155,336	154,117			0.79%
Other Operating	346,983	236,576			46.67%
Total Expenses	\$1,879,455	\$1,988,556			-5.49%
Net Operating Surplus (Deficit)	\$403,329	\$537,536			-24.97%

Operating Revenues

For Fiscal Year 2013, NC's revenues totaled \$2.3 million, a decrease of \$243,308 (-9.6 %) over Fiscal Year 2012. Operating revenues for NC consist of the following: loan interest income, grant income, loan fees, investment income, other fees and satisfaction of program restrictions.

The comparison of Operating Revenues for FY 2013 to FY 2012 is influenced by the inclusion of \$500,000 in Satisfaction of Program Restriction revenue in FY 2012 (**). There was no activity for Satisfaction of Program Restriction revenue related to pass through grants facilitated by the Organization in FY 2013. Removing this item for comparison purposes yields an **Increase** of \$256,692 (13%) for FY 2013, compared to an adjusted Total Operating Revenue amount for FY 2012.



Earned income (comprised of loan interest income, loan fees, investment income and other fees) for 2013 increased by \$334,035 (18.8%) over 2012. As illustrated above, the largest category of revenue in 2013 was loan interest income with \$1.82 million compared to \$1.59 million in 2012, a 15.1% increase over the previous year and reflects NC's loan portfolio growth (net of allowance) of 20.7% over FY 2012.

Loan Fees from loan originations was \$246,196 in 2013, an increase of \$90,449 (58.1%) compared to 2012 and reflects the 72% increase in lending volume over FY 2012 lending volume.

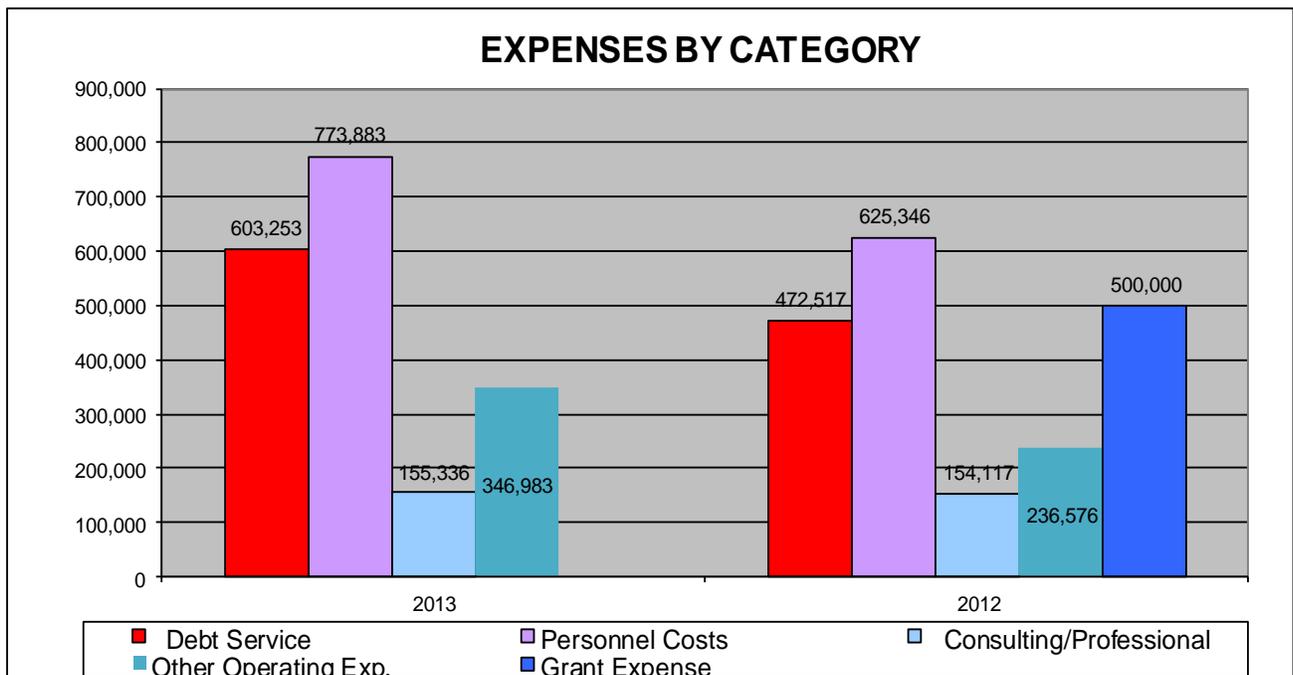
Grant Income accounted for \$175,000 in 2013, a decrease of \$77,343 (-30.7%) from 2012. The decrease is attributed to a planned reduction in the operational grant from NeighborWorks® America from the previous year. This income is excluded in the determination of the Organization's self sustainability percentage, which was 112% for 2013 and 114% for 2012.

Investment Income (interest) provided \$14,300 in revenues in 2013, a decrease of \$9,695 (-40.4%) over last fiscal year. Other fees consist of loan servicing fees on participation loans, which increased \$12,908 (219.9%), compared to 2012 and reflect greater activity in the loan participation area.

Operating Expenses

For the Fiscal Year 2013 NC's operating expenses decreased by \$109,101(-5.5%) to \$1.88 million, compared to \$1.99 million in 2012. NC's operating expenses are comprised of the following major categories: Debt Service, Personnel Costs, Consulting and Professional, Grant Expense and Other Operating Expenses.

The comparison of Operating Expenses for FY 2013 to FY 2012 is influenced by the inclusion of \$500,000 in Grant Expense in FY 2012 (**). There was no activity for Grant Expense related to pass through grants facilitated by the Organization in FY 2013. Removing this item for comparison purposes yields an Increase of \$390,899 (26%) for FY 2013, compared to an adjusted Total Operating Expenses amount for FY 2012.



Personnel Costs accounted for \$773,883 of NC's operating expenses for 2013, compared to \$625,346 for 2012, an increase of \$148,537 (23.7%). Personnel Costs include the salaries for 6 FTE in 2013 and 5 FTE in 2012, as well as payroll taxes and benefit plans (disability, health, life and retirement) for the full time staff of NC. The Organization added a Loan Administrator in September of 2013.

Debt service expense increased by \$130,736 (27.7%) to \$603,253 for the fiscal year compared to \$472,517 for 2012. The increase in 2013 is the result of higher debt financing compared to 2012 reflecting a 44% increase in Notes Payable at year end 2013, compared to year end 2012.

Consulting and Professional expenses were \$155,336 in 2013, compared to \$154,117 in 2012 an increase of \$1,219 (0.8%). This expenses include audit fees, consulting services (accounting, business planning, loan underwriting, human resources and information technologies), and legal fees.

Other Operating Expenses increased \$110,407 (46.7%) to \$346,983 for 2013, versus \$236,576 in 2012 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 expenses for marketing, business travel for staff and amortization/depreciation.

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 continues to make the overall loan portfolio risk rating come in below the investor covenant requirement.

Portfolio Management Information				
	FY 2013	FY 2012	FY 2011	FY 2010
Total Loan Portfolio	\$36,644,903	\$30,366,586	\$30,379,907	\$25,883,320
Interest Delinquencies over 30 days	0%	0%	0%	0%
Loan Loss Reserve Per Risk Rating	4.07%	5.02%	4.54%	6.29%
Loan Loss Reserve Per Investor Covenants	6.00%	6.00%	6.00%	6.00%
Loan Write-offs	\$396,887	\$0	\$51,486	\$75,000
Loan Write-offs Percentage (Total of Loan Port.)	1.08%	0.00%	0.20%	0.30%
Credit Quality – Adequate and Above	96%	92%	96%	93%

Strategic Plan

In 2013 the Board of Directors of NC engaged a leading CDFI expert to facilitate a strategic planning process. Having successfully completed a previous strategic plan, NC wanted to assess the Organization's performance and impact and better understand our customers, real estate trends and the CDFI industry.

To best determine where the Organization should focus its lending program for the NeighborWorks® America network the NC's Board interviewed current, former and future customers and received valuable input and feedback on how to direct our capital resources. Consultants and staff engaged leading housing CDFIs and investors as well. This was followed by a research phase, consisting of a scan of various opportunities and trends in the CDFI industry which provided a deeper understanding of NC's competitive position including an analysis of loan demand within the NeighborWorks® America network, trends at similar CDFIs, and availability of various types of capital. As a result, NC's Board developed a set of five bold and dynamic goals for the years 2014-2018.

- ◆ *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*

Business Goals for Fiscal Year 2014

Looking forward to 2014, NC's business plan includes the following goals:

- ⊙ Continue to increase NC's market share of NeighborWorks® America organizations by 5% as a result of greater marketing, outreach and expansion of business relationships.
- ⊙ Originate \$44.4 million in new loans, with \$6.5 million as the result of loan participations, an increase of 56% over 2013.
- ⊙ Increase loan capital by \$16.1 million to support the projected increase in lending volume.
- ⊙ Achieve a Self Sustainability Ratio of at least 125%.

Please read more about our results in our **2013 Annual Report** on the Publications page of our website.