



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, 2012. 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 distressed areas.

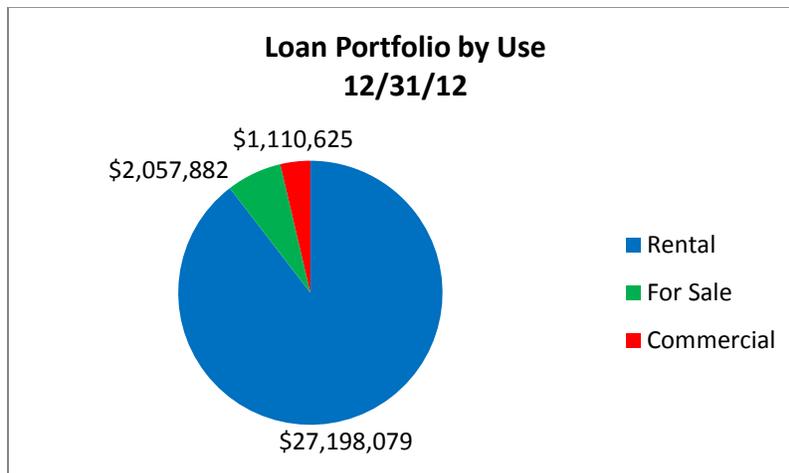
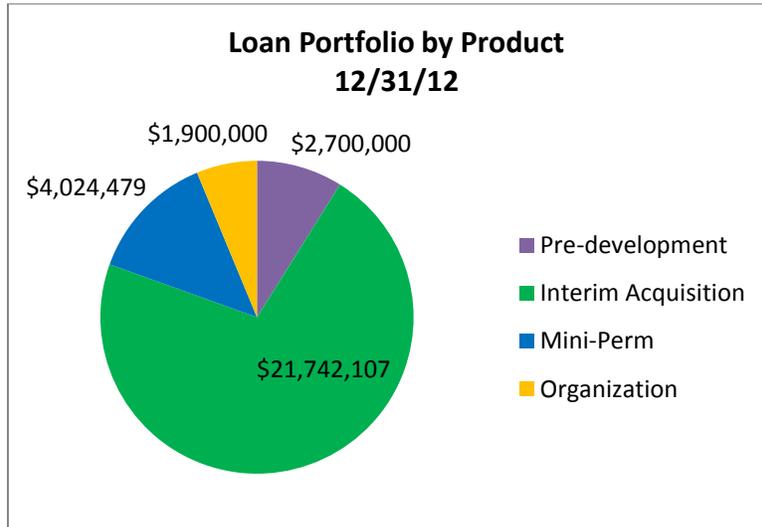
Annual Business Goals

In 2012 NeighborWorks® Capital achieved the following:

- ☑ Increased NC's lending volume by over 10% compared to 2011
- ☑ Raised \$15.0 million in new lending capital
- ☑ Increased net assets by 12.5%
- ☑ Improved operating sustainability to 114%
- ☑ Increased NC's market share by 4% with 4 new customers
- ☑ Originated \$16.6 million in loans, leveraging \$77.3 million in construction or permanent financing (5:1 leverage)

- ☑ Lending to 13 projects for 636 rental and for-sale housing units, of which 98% 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 18 months. The primary real estate type used for NC's loans is rental followed by for sale and commercial property.



NC was able to secure \$15.0 million in additional lending capital to meet the needs of lending activity in 2012, bringing NC's total available lending capital to \$47.5 million. The \$15.0 million in additional lending capital was a combination of \$12.75 million in debt investments and \$2.25 million in an equity capital grant from NeighborWorks® America. The \$12.75 million in new debt was comprised of investments from Morgan Stanley, PNC Bank and Wells Fargo, with increased and renewed investments on existing credit facilities from Ally Bank and The Calvert Foundation. We are appreciative of these investors' confidence in our lending activities.

Review of Financial Results for Fiscal Year 2012

NC's Statement of Financial Position for the year ended December 31, 2012 continues to show growth and strength as the result of its loan portfolio, acquiring new sources of debt financing, continued equity capital support from NeighborWorks® America and a strong net operating surplus for Fiscal Year 2012. For Fiscal Year 2012, total assets increased 9.4% over the prior year, while total liabilities and total net assets increased 4.6% and 12.5%, respectively over the previous fiscal year.

During 2012, the Organization changed its method of recognition for participation loans where the Organization is the lead lender. The method conforms more closely with current industry practice. Both 2012 and 2011 in the Condensed Statement of Financial Position reflect the change in the recognition method.

Condensed Statement of Financial Position			
	<u>2012</u>	<u>2011</u>	Total Percentage Change
<u>ASSETS</u>			
Cash, Cash Reserves and Cash Equivalents	\$9,155,674	\$5,936,243	54.23%
Loans Receivable (net of Allowance)	\$28,544,591	\$28,513,409	0.11%
Capital Assets (net)	\$42,639	\$63,348	-32.69%
Other Assets	\$180,090	\$146,567	22.87%
Total Assets	<u>\$37,922,994</u>	<u>\$34,659,567</u>	<u>9.42%</u>
<u>LIABILITIES</u>			
Notes Payable	\$13,000,000	\$13,333,334	-2.50%
Equity Equivalent Investments	\$1,000,000	\$0	n/a
Other Liabilities	\$328,728	\$360,637	-8.85%
Total Liabilities	<u>\$14,328,728</u>	<u>\$13,693,971</u>	<u>4.64%</u>
<u>NET ASSETS</u>			
Unrestricted	\$3,212,149	\$2,317,610	38.60%
Temporarily Restricted	\$2,016,995	\$2,577,367	-21.74%
Permanently Restricted	\$18,365,122	\$16,070,619	14.28%
Total Net Assets	<u>\$23,594,266</u>	<u>\$20,965,596</u>	<u>12.54%</u>

Assets

Cash 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 \$67,559 (-1.5%) as the result of decreases in the interest reserves for borrowers and a sight decrease in loan loss reserves. Loan capital cash increased by \$3,286,990 (235%) over 2011 due to the increase in new loan capital, the volume of loan repayments and lower than anticipated lending volume. NC's working capital is extremely strong as of the end of 2012, reflecting low Current Liabilities resulting in a current ratio of 69.3 to 1, compared to 6.8 to 1 in 2011.

Loans Receivable (net)

NC disbursed \$8.7 million in loans during 2012, compared to \$15 million in 2011. As the result of lower than anticipated lending activities in 2012, the Organization's outstanding loans, net of loan loss reserves were \$28.54 million in 2012, compared to \$28.51 million in 2011. NC had \$5.75 million in loan commitments outstanding at year end.

Capital Assets

Capital assets (furniture, hardware, software and tenant improvements) decreased by \$20,709 (-32.7%) over 2011, net of disposals, as the result of amortization and depreciation.

Other Assets

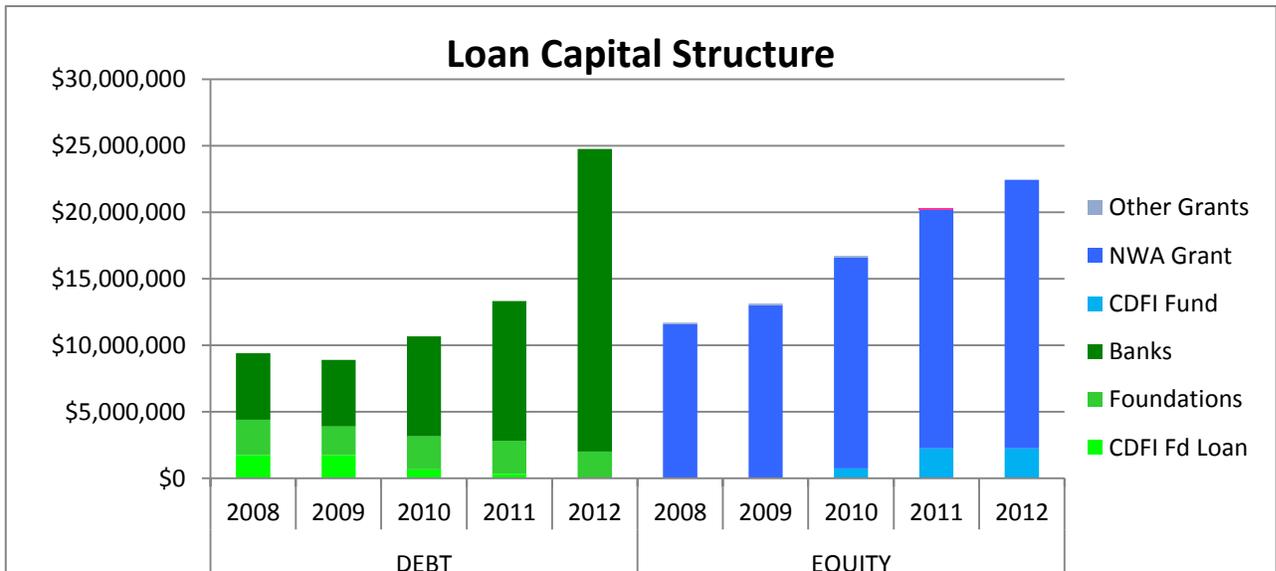
Other assets increased \$33,523 (22.9%) over 2011 as the result of an increase in prepaid costs that will be amortized over future months.

Liabilities

Notes Payable and Equity Equivalent Investments

In 2012, NC secured \$12.75 million in new debt and equity equivalent facilities. During the year, a \$1.0 million equity equivalent investment and \$1.0 million in debt financing were drawn down. Net of debt repayments, Notes Payable decreased by \$333,334 (-2.5%) to an overall total of \$13.0 million. The current outstanding debt and equity equivalent investment has an average maturity of 4.7 years, with individual maturities ranging from 16 months to 9.5 years. NC has \$10.75 million in lines of credit available at year end for financing.

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 42% equity and 58% debt and has a combined total of \$47.5 million at the end of 2012.



Other Liabilities

Other liabilities decreased by 8.9% over the previous year, primarily due to changes in accrued liabilities and deferred interest income.

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 \$2.6 million (12.5%) in Fiscal Year 2012, compared to Fiscal Year 2011. The majority of the increase was from \$2.25 million in permanently restricted capital contributions from NeighborWorks® America. NeighborWorks® America also provided NC with a \$250,000 expendable operational grant that contributed significantly to the \$537,536 net operating surplus for Fiscal Year 2012.

Fiscal Year 2012 Operations

NC achieved a net operating surplus of \$537,536 for 2012, a 54% increase over 2011's net operating surplus of \$349,665. This is NC's third consecutive year of net operating surpluses. The 2012 results yielded a self sustainability percentage of 114%, compared to a self sustainability percentage of 97% for 2011.

As mentioned in the Financial Results for Fiscal Year 2012 section, the Organization changed its method of recognition for participations in 2012. To provide a more accurate and realistic comparison of the components of operating revenues and expenses, noted components for 2011 have been adjusted to reflect what the impact would have been from the participation recognition method change if applied in 2011.

FY 2012 and FY 2011-Adjusted Operating Revenue and Expense Comparison			
	<u>2012</u>	<u>2011</u>	<u>Total Percentage Change</u>
REVENUE			
Grant Income	252,343	350,000	-27.90%
Loan Fees	155,747	150,671	3.37%
Loan Interest	1,588,137	1,265,686 <i>i</i>	25.48%
Investment Income and Other Fees	29,865	28,231 <i>ii</i>	5.79%
Satisfaction of Program Restrictions	500,000	369,380	35.36%
Total Revenue	<u>\$2,526,092</u>	<u>\$2,163,968</u>	16.73%
EXPENSE			
Debt Service	472,517	439,560 <i>iii</i>	7.50%
Grant Expense	500,000	283,800	76.18%
Personnel and Benefits	625,346	709,326	-11.84%
Consulting/Professional	154,117	189,667	-18.74%
Other Operating	236,576	191,950 <i>iv</i>	23.25%
Total Expenses	<u>\$1,988,556</u>	<u>\$1,814,303</u>	9.60%
Net Operating Surplus (Deficit)	<u>\$537,536</u>	<u>\$349,665</u>	53.73%

Note:

i-This number has been reduced by \$62,901 for participation impact

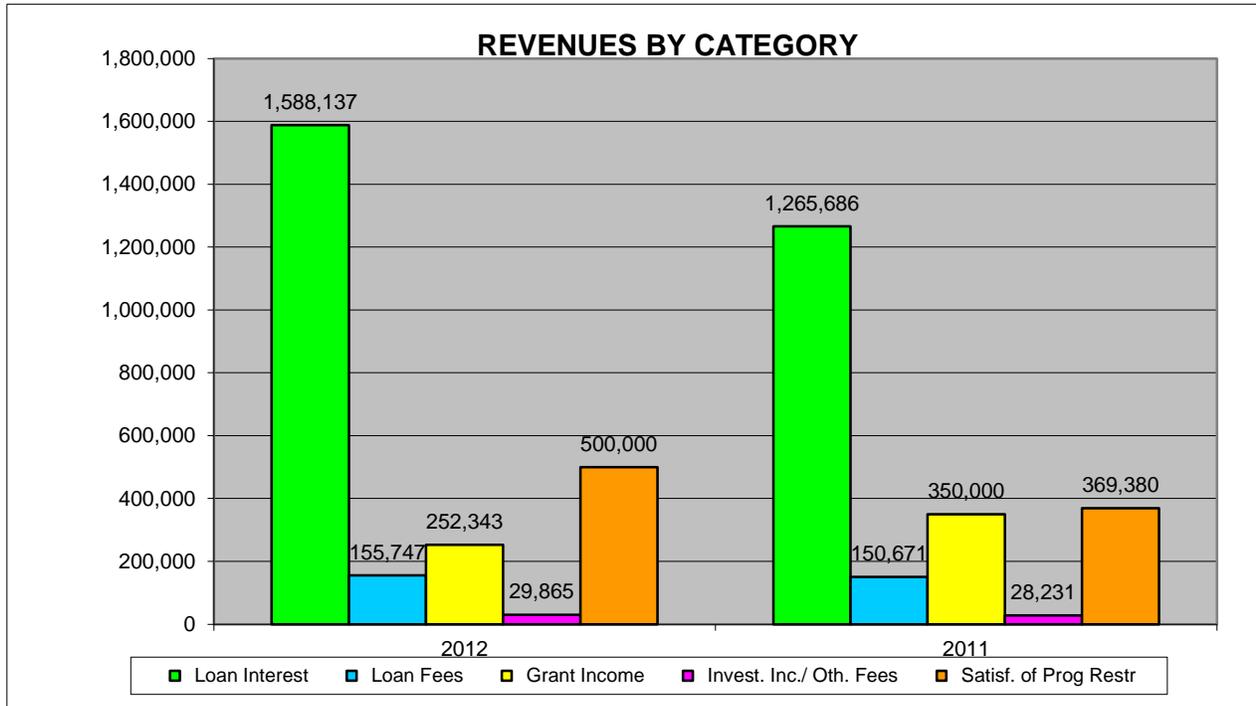
ii-This number has been increased by \$1,793 for participation impact

iii-This number has been reduced by \$66,248 for participation impact

iv-This number has been increased by \$5,140 for participation impact

Operating Revenues

For Fiscal Year 2012, NC's revenues totaled \$2.53 million, an increase of \$362,124 (16.7 %) over Fiscal Year 2011, as adjusted for loan participation impact. Operating revenues for NC consist of the following: loan interest income, grant income, loan fees, investment income, other fees and satisfaction of program restrictions.



Earned income (comprised of loan interest income, loan fees, investment income and other fees) for 2012 increased by \$329,161 (22.8%) over 2011. As illustrated above, the largest category of revenue in 2012 was loan interest income with \$1.59 million compared to \$1.27 million in 2011, a 25.5% increase over the previous year.

Grant Income accounted for \$252,343 in 2012, a decrease of \$97,657 (-27.9%) over 2011. 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 114% for 2012 and 97% for 2011.

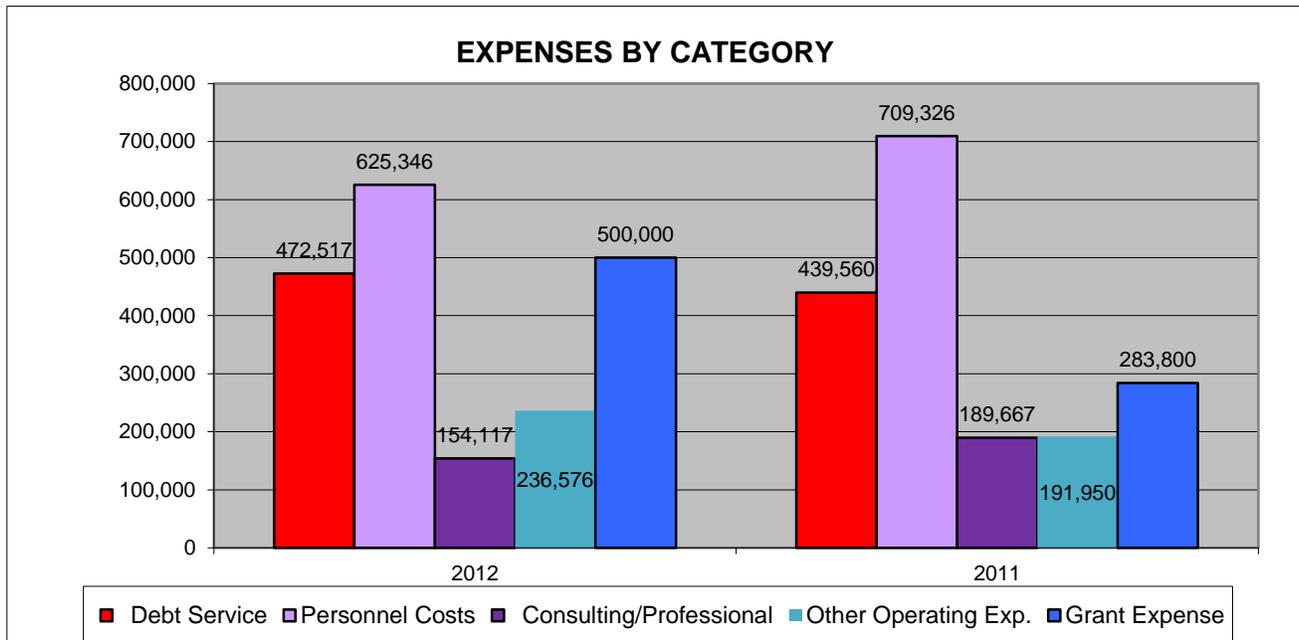
Loan Fees from loan originations was \$155,747 in 2012, an increase of \$5,076 (3.4%) compared to 2011.

Investment Income (interest) and other fees provided \$29,865 in revenues in 2012, a \$1,634 (5.8%) increase over last fiscal year. Other fees refer to a small amount of revenue for loan servicing fees on participation loans.

Operating Expenses

For the Fiscal Year 2012 NC's operating expenses increased \$174,253 (9.6%) to \$1.99 million, compared to \$1.81 million in 2011, as adjusted for loan participation impact. NC's operating

expenses are comprised of the following major categories: Debt Service, Personnel Costs, Consulting and Professional, Grant Expense and Other Operating Expenses.



Personnel Costs accounted for \$625,346 (31%) of NC’s operating expenses for 2012, compared to \$709,326 for 2011, a decrease of \$83,980 (-11.8%). Personnel Costs include the salaries for 5 FTE in 2012 and 5 FTE in 2011, as well as payroll taxes and benefit plans (disability, health, life and retirement) for the full time staff of NC. The Organization experienced a transition in the lending management position in 2012.

Debt service expense increased by \$32,957(7.5%) to \$472,517 for the fiscal year compared to \$439,560 for 2011, as adjusted for loan participation impact. The increase in 2012 is the result of higher actual debt financing compared to 2011.

Consulting and Professional expenses were \$154,117 in 2012, compared to \$189,667 in 2011 a decrease of \$35,550 (-18.7%). This expenses include audit fees, consulting services (accounting, business planning, loan underwriting, human resources and information technologies), and legal fees. The decrease in 2012 is attributed to lower expenses associated with consulting/professional services for information technologies.

Other Operating Expenses increased \$44,626 (23.3%) to \$236,576 for 2012, versus \$191,950 in 2011 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 and amortization/depreciation.

Grant Expenses are related to pass through grants facilitated by the Organization and are off set by the satisfaction of program restrictions revenue line.

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.

Portfolio Management Information				
	2012	2011	2010	2009
Total Loan Portfolio	\$30,366,586	\$30,379,907	\$25,883,320	\$16,075,255
Interest Delinquencies over 30 days	0%	0%	0%	0%
Loan Loss Reserve Per Risk Rating	5.02%	4.54%	6.29%	5.78%
Loan Loss Reserve Per Investor Covenants	6.00%	6.00%	6.00%	N/A
Loan Write-offs	\$0	\$51,486	\$75,000	\$702,377
Loan Write-offs Percentage (Total of Loan Port.)	0.00%	0.20%	0.30%	4.40%
Credit Quality – Adequate and Above	92%	96%	93%	92%

Information Technology

NC continues to research new ways the Organization's loan management system and website can be utilized to collect and organize important impact data from borrowers and provide efficient communication to NC's borrowers, potential borrowers and investors.

Business Goals for Fiscal Year 2013

Looking forward to 2013, NC's business plan includes the following goals:

- ⊙ Continue to increase NC's market share of NeighborWorks® America organizations by 4% as a result of greater marketing, outreach and expansion of business relationships.
- ⊙ Originate over \$28.25 million in new loans, an increase of 70% over 2012.
- ⊙ Increase loan capital by almost \$9.75 million to support the projected increase in lending volume.
- ⊙ Achieve a Self Sustainability Ratio of at least 100%.

In addition to its annual goals the NeighborWorks Capital Board of Directors is undertaking a strategic planning process with the senior management team and a CDFI consultant to gain

additional information on financing needs of its customers, capital structures and organizational infrastructure to grow its lending impact and capital resources over the next five years. NC has identified the following factors in the current business environment that may have an impact on the ability of NC to meet its business goals for 2013:

- Funding vulnerability of federal budget reductions for affordable housing programs (HOME, CDBG, NSP, and 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, property valuations, reduced real estate portfolio performance, organizational financial health, and stalled or compromised development projects.
- Availability and pricing of significant new investor capital.

Please read more about our results in our **2012 Annual Report** on the Publications page of our website.