NeighborWorks® CAPITAL

Audit 2020
Management Discussion Analysis

Overview
2020 was an extraordinary year for the world and impacted all of us as we moved to remote work environments, and many businesses paused to assess the impact of the pandemic on business risk, employee safety and business continuity. NeighborWorks Capital was able to move to a remote work environment, maintaining strong operating controls, and to support the NeighborWorks America network with new loan product, COVID loan accommodations and new capital. Production was down year over year with $27.2MM in new loans closed.

The table below, found on this page and in Note 4 page 23 of the accompanying audit, isolates the COVID related activity within the loan portfolio. There were 4 requests for accommodation in payment driven by COVID pandemic – two borrowers asked for relief from payment of principal asking to pay only interest, and 2 borrowers asked for temporary relief from all debt service requirements for 6 months (columns below titled "Principal deferred/interest-only" and "Full payment deferral"). These accommodations were granted.

The third column represents a new loan product offered to provide short-term working capital for borrowers and each loan had a capitalized interest reserve. These new loans are for terms of up to three years.

	Principal deferred/interest-only		Full payment deferral		Capitalized interest COVID Response Loans		Total	
December 31, 2020	Amount	# of Loans	Amount	# of Loans	Amount	# of Loans	Amount	# of Loans
Predevelopment	$ -	-	$ -	-	$ -	-	$ -	-
Acquisition - Land	-	-	-	-	-	-	-	-
Bridge	-	-	-	-	-	-	-	-
Building acquisition	2,485,306	1	1,953,000	1	-	-	4,438,306	2
Construction	-	-	-	-	-	-	-	-
Enterprise	1,000,000	1	-	-	1,692,279	4	2,692,279	5
Mezzanine/equity	-	-	-	-	-	-	-	-
Mini-Permanent	-	-	1,686,239	1	-	-	1,686,239	1
Permanent	-	-	-	-	-	-	-	-
	$ 3,485,306	2	$ 3,639,239	2	$ 1,692,279	4	$ 8,816,824	8

Discussion of changes of internally prepared statements vs. audit

The 2020 unqualified audited financial statements are attached for your review. These vary in a few areas from the internally prepared year end financials previously provided. The changes, for ease of comparison, are as follows:

Statement of Financial Position

1. Management made the determination that it had met the conditions pursuant to $100K in grants and they were released from Temporarily Restricted to unrestricted BOD Lending Capital.
2. NeighborWorks America ("NWA"), subsequent to release of the interim financial statements, approved a release from Permanently Restricted Assets to Unrestricted Net Assets the amount of the loss taken on the Paulsboro loan or $836,775.
3. Other assets including deposits of $7,500 and Long Terms Investments – MP/Starling Holdings of $3,000 were combined to reflect $10,000.
4. Accounts Receivable was reduced by $551 which is why total assets were lower by $551 in the audit compared to internal statements.
5. There was a reclassification to Current Loans Receivable from Long Term Loans Receivable of $727,500 such that the audit current assets are higher than the internally presented statements representing reclassification of the RUPCO LOC loan maturing 12/1/2021.

Statement of Activities

1. The loan loss reserve amount was increased by $836,775 to reflect Paulsboro loan charge-off. This allowed NWA capital to move from Restricted Capital to First Use Capital and then to Unrestricted Net Assets.

Audit Analysis

Total assets at year end 2020 were $106.3MM up from $102MM at FYE 2019. This was driven by growth in the loan portfolio which increased from $97.4MM to $104.4MM. This was achieved through advances of $35.3MM on portfolio loans and new loans closed, less principal curtailments and loan payoffs of $27.4MM and write-offs of $837K related to the Paulsboro Plaza loan. This loss brings the cumulative fund losses to .61% gross and .48% net of recoveries. The loan loss reserve at 12.31.20 was $6MM compared to $3.4MM at FYE 2019, this increase partially offset the growth in loans outstanding. The increased loan loss reserve is primarily in the unallocated portion of the reserve which anticipates further funding of Spruce Ridge as well as potential additional credit quality deterioration. (The details are in the credit charts later in this memo.) Total cash and investments were $7.1MM at 12.31.20, compared to $7.4MM at 12.31.19. There was also, for the first time, $209K in long term interest receivables representing deferred interest on Teche Ridge, Lamar Life, and Marriner loans that were either COVID accommodations or part of the transaction restructure such as Teche Ridge.

The asset growth was supported by an increase in notes payable of $4.2MM. New capital included a $2MM equity equivalent investment from BBVA, $3.5MM increase in our line from Morgan Stanley, a $5MM increase from Schwab and $2.5MM in grants from NeighborWorks America. NC did make $3.5MM of scheduled principal paydowns on the Bank of America and

Kresge loans. Net assets year over year remained virtually unchanged with the increase to loan loss reserves offsetting the increase unrestricted operating capital ($1.1MM) and lending capital ($2.5MM). Donor restricted net assets declined by $836,775 as NeighborWorks America released from restrictions the Paulsboro loan write-off.

	12/31/2019	12/31/2020	$ Change	Comments
Assets	$ 101,967,537	$ 106,269,065	$ 4,301,528	Driven by new loans and advances as offset by repayments
Liabilities	$ 56,265,937	$ 60,388,124	$ 4,122,187	Debt drawn to fund new loans + EQ2 of $2MM
Net Assets	$ 45,701,600	$ 45,880,941	$ 179,341	
	2019	2020	$ Change	
Revenue	$ 7,724,598	$ 8,329,193	$ 604,595	Lower Volume Closings
Expenses	$ 4,887,816	$ 8,149,851	$ (3,262,035)	Provision for loan loss reserve increased $2.6MM
Net Operating Surplus	$ 2,836,782	$ 179,342	$ (2,657,440)	

The surplus was $179K for the year with the write-off of Paulsboro and the increased loan loss reserve expense. Total revenue for the year was $8.3MM with $2.5MM in grant income and $5.8MM in earned revenue. The earned revenue was higher by $500K than that achieved in 2019, but lower than budgeted due to lower than projected average outstanding balances due to production volume of $27.2MM compared to the original budget of $59.7MM. This was offset by reduced borrowing expenses due to less average debt outstanding and due to a reduction in borrowing costs. Additionally, there was less spending in travel and consulting as well as occupancy. For the year, NC's earned revenue exceeded expenses generating a 123% self-sufficiency ratio.

	12/31/2019	12/31/2020	$ Change	Comments
Working Capital	$ 33,616,066	$ 26,019,716	$ (7,596,350)	Decrease attributable to higher current assets ($13.5MM notes payable vs. $3.5MM)
Current Ratio	9.31	2.81		Short term liabilities increased by $10MM (principal curtailment due)
Days Cash	274.7	215.7		Expenses per day increased from $11,592 to $12,937 and cash declined
Liquid (nonlending cap. Unrestricted)	$ 3,184,294	$ 2,790,424	$ (393,870)	
Lending Capital	$ 3,861,395	$ 4,265,384	$ 403,989	
Leverage	1.23	1.32		
Self Sufficiency	125%	123%		Operating Revenue (excludes grant income and loan loss reserve expense)

Key ratios at 12.31.20 contrasted to the prior year end are reflected above. The leverage of the Organization as measured by Total Liabilities to Net Assets has risen to 1.32x. This trend will continue to the extent loan growth continues during 2021. NC was awarded $2.5MM by NWA for lending capital and closed a $2MM equity equivalent investment with BBVA, and a $3.5MM increase to the Line of Credit with Morgan Stanley. NC is preparing to close an increase of $3MM to the US Bank line. These funds will be available to address maturing debt or principal curtailments of $13.5MM ($2MM BoA, $1.5MM Kresge, $4MM PNC, $1MM Cap One, $5MM Wells Fargo).

Liquidity as measured by days cash exceeds investor requirements at 216 days cash on hand. Cash is lower in part due to an increase in deferred interest ($209K). Working capital and current ratios both reflect NC's ability to meet its obligations as they become due.

Key credit quality indicators are reflected in the table below. Of note, the impact of Spruce Ridge moving to non-accrual plus the total loans that are past due 30 days or more increasing to 6.4% of the portfolio (8.3% at the end of the first quarter with additional expected advances under Spruce Ridge loan). Also the degree of risk in the portfolio as measured by the percentage of the portfolio on Questionable/Watch List and Enhanced Monitoring has increased. As reflected in the second chart, NC raised its loan loss reserves to address this additional risk. The portfolio management team has completed an extensive review of loan risk ratings, annual reviews, and portfolio performance and is comfortable with the reserves in place to address future potential losses.

	2019	2020
Portfolio Size	$ 97,405,988	$ 104,415,360
% > 30 days past due	0.0%	1.6%
Total non-performers (includes nonac	1.9%	6.4%
Questionable/Watch List % of portfoli	4%	10%
Enhanced Monitoring % of portfolio	10%	15%

	12/31/2019	12/31/2020	$ Change	Comments
Delinquency > 30 days	$ -	$ 1,686,239	$ 1,686,239	Lamar Life Loan
Non-accrual	$ 1,811,775	$ 5,008,789	$ 3,197,014	Paulsboro loan replaced by Spruce Ridge Loan
Charge-offs	$ -	$ 836,775	$ (836,775)	Paulsboro partial charge-off
Recoveries	$ -	$ -	0	
Reserves - allocated	$ 3,332,202	$ 3,801,174	$ 468,972	Increase driven by downgrade to Spruce Ridge
Reserves - unallocated	$ 76,768	$ 2,198,826	$ 2,122,058	
Total reserves	$ 3,408,970	$ 6,000,000	$ 2,591,030	
% of loans outstanding	3.50%	5.75%		
Questionable/Watch List	$ 3,575,906	$ 10,294,976	$ 6,719,070	Increased for Spruce Ridge I and II which moved from Enhanced Monitoring and Lamar Life
Enhanced Monitoring	$ 10,224,910	$ 15,595,723	$ 5,370,813	12 loans on EM including addition of AHSTI, Huntington Square, Marriner, NHS, Ridge Apts
Portfolio Size	$ 97,405,988	$ 104,415,360	$ 7,009,372	

Comments on 2021

The 2021 budget forecasts a return to a more stable operating environment.

Budget Headlines include:

- $60MM in new loan volume
- Increase loan loss reserves to 6% with a reevaluation after Spruce Ridge is repaid
- $120.5MM FYE 2021 retained loan portfolio
- Net operating surplus of $981,562
- New capital of $17.5MM
- 1 staff addition supporting loan closing

Credit quality indicators are expected to get worse before improving at year end/into the first quarter of 2022. There are two loans driving delinquency - Spruce Ridge (3.31.21 balance of $7,490,391) which is on nonaccrual and Lamar Life (3.31.21 balance of $1,682,181) which is not yet on nonaccrual but is greater than 120 days past due.

The Spruce Ridge workout, previous overview distributed to all investors, is currently underway. The key milestones completed have been: 1) removal of liens on the property; 2) replacement of the former GC; 3) additional dollars from DOH in Connecticut; 4) commencement of work to complete the project. Additionally, the admittance of a new tax credit investor was to be completed by end of April. The tax credit syndicator has been admitted to the operating entity, the investor is currently completing due diligence and is scheduled to enter the agreement not later than June 1. Construction will be completed on the first of two buildings by end of June, and on the second building by mid-August. Advances during 2021 are expected to add an additional $3.1MM in outstandings to the nonaccrual. The property then needs to lease up and operate at stabilized occupancy for 90 days prior to conversion to permanent loan and payment of tax credit equity both of which will reduce the construction loan balance and result in delinquency ratio dropping down to more normal levels.

The Lamar Life loan has been struggling to find its footing relating to lease up of first floor commercial space in the mixed-use property (apartments and retail). The loan was given a 90-day COVID accommodation with a deferral of payments. When the deferral ended the borrower resumed interest payments making four payments before being unable to keep the loan current any longer. An appraisal has been ordered, no further funding is anticipated under the loan.

At present, there are no other slow pays or delinquencies > 30 days in the portfolio.