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NeighborWorks Capital, Maryland; General Obligation

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Credit Profile

Credit Highlights

- S&P Global Ratings assigned its 'A+' issuer credit rating (ICR) to NeighborWorks Capital Corp., Md.
- The outlook is stable.

Security

An ICR reflects the obligor's general creditworthiness and capacity and willingness to meet financial commitments when they come due. It does not apply to any specific financial obligation and does not consider the obligation's nature and provisions, bankruptcy standing, liquidation, statutory preferences, or legality and enforceability.

Credit overview

Key strengths supporting NeighborWorks' ICR include its capital adequacy, profitability, and liquidity, and our view of management. Its near-term strategy includes increasing total assets and lending capacity by potentially increasing leverage on the balance sheet. We will monitor the potential effects of the scale and timing of this growth on our view of the ICR.

The rating reflects our view of NeighborWorks':

- Financial strength, measured by about \$55.4 million in equity and its net equity-to-assets ratio of 31.7% in fiscal 2022 and five-year average of 25.1%, which we view as above average relative to its peers, despite more limited funding sources than other rated community development financial institutions (CDFIs);
- Average profitability compared with its peers with return-on-average assets (ROA) of about 3.1% between fiscal years 2018 and 2022, but its five-year average net interest margin (NIM) of 3.4% exceeds its peers;
- Below-average asset quality compared with its peers, measured by a nonperforming-assets (NPAs)-to-total assets ratio averaging 6.1% between fiscal years 2018 and 2022 due largely to one sizable construction loan that encountered challenges starting in 2020, as well as loan loss reserves averaging 4.5%;
- Adequate liquidity, measured by a total loans-to-total assets ratio of 86% and a short-term investments-to-total assets ratio of nearly 13% with about \$76.5 million in undrawn external liquidity by fiscal year-end 2022, which exceeds total debt outstanding; and
- Strong management team and board members with extensive experience in the industry and a successful record of adapting to challenging circumstances while maintaining a long-term strategy to aligns with its mission.

NeighborWorks is a national nonprofit community development-loan fund founded in 2008 with funding from NeighborWorks America, a congressionally chartered organization. Its mission includes providing NeighborWorks America network members nationwide access to flexible capital for the acquisition, preservation, or construction of

affordable housing properties and commercial projects. NeighborWorks operates under a five-year master investment agreement with NeighborWorks America, and the current agreement states that the latter will provide between \$1 million and \$5 million annually in capital funds. Outside of this agreement and annual funding, NeighborWorks operates independently and NeighborWorks America guarantees none of its obligations.

Environmental, social, and governance

We have analyzed environmental, social, and governance (ESG) factors relative to NeighborWorks' financial strength, management and legislative mandate, and local economy; we view these risks as neutral to our credit analysis. We think its loan portfolio may have exposure to certain environmental factors, such as climate transition and physical risk based on its location. Insurance requirements and NeighborWorks' loan monitoring partially mitigate these risks.

Outlook

The stable outlook reflects S&P Global Ratings' view that NeighborWorks will likely maintain above-average capital-adequacy ratios based on its lending and debt strategy, growth plans, and portfolio monitoring strengths. We expect its equity will likely remain more than 40% of total assets during the next two years and that net equity will remain above 20% on a five-year average. At the same time, management has adapted its loan underwriting and requirements in response to larger recent nonaccruals, which had a material effect on asset quality given the portfolio size; therefore, we think asset quality will likely improve during the two-year outlook. Unaudited June 2023 financials indicate net equity could remain in line with its five-year average, if not increase several basis points.

Downside scenario

We could lower the rating or revise the outlook to negative if NeighborWorks were to increase its debt load significantly to expand its loan portfolio aggressively, leading to a decreased net equity-to-assets ratio. The use and size of proceeds will affect our view of potential debt increases during the two-year outlook. Decreases in profitability or significantly reduced liquidity available to meet short-term needs could also be signs of credit weakness that lead us to lower the rating or revise the outlook to negative.

Upside scenario

We could raise the rating or revise the outlook to positive if the net equity-to-assets ratio were to continue exceeding 25% consistently, coupled with sustained strength in profitability and continued improvement in asset quality. We believe management's thoughtful strategic planning can limit the potential for increased leverage to pressure its capital adequacy ratios, and bring its credit profile in line with a higher rating level. We think NeighborWorks' growth strategy could lend to a more diverse revenue composition, which could increase ROA. In addition, should the organization receive other grants from various sources, it could also increase profitability.

Credit Opinion

Financial Risk Profile

Capital adequacy

We consider NeighborWorks' capital adequacy above other CDFIs' average based on a five-year average net equity-to-assets ratio of 25.1%. In fiscal years 2018 and 2019, increases in debt outpaced increases in gross loan balance as NeighborWorks sought to grow its portfolio; this trend reversed in fiscal years 2021 and 2022, when it repaid more debt and the equity-to-assets ratio rose. In fiscal 2022, total assets grew by 1% since fiscal 2021 while total liabilities decreased by 4%, supporting an 8% equity increase, by fiscal year-end 2022; equity reached a high 51% of total assets.

In addition to the receipt of additional capital, in part from the CDFI fund's capital magnet fund, the modest assets increase during fiscal 2022 included the financing of new predevelopment, bridge, and other early-financing loans. In the near term, as it continues executing on a growth strategy, we expect the equity-to-assets ratio to decrease but not beyond levels we think would constrain the current rating; as of June 2023, equity was about 47% of total assets.

Our analysis tends to place the highest emphasis on net equity because this indicates resources available to sustain operations during difficult circumstances; it also indicates an organization's capacity to fund programs that further its mission. Using our methodology for rating mortgage revenue bond programs, we calculate projected loan losses based on specific portfolio characteristics and use these assumed losses in deriving a net equity ratio.

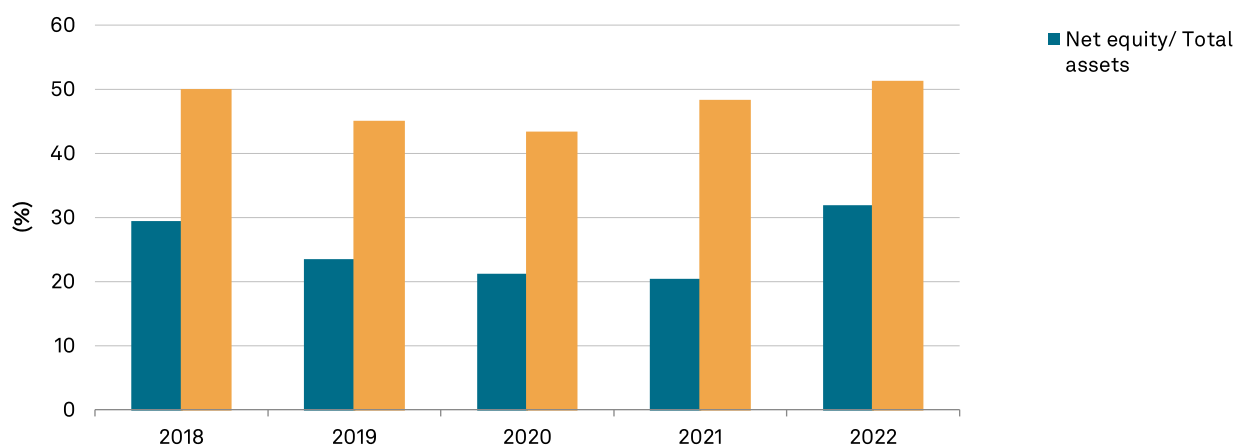
Our analysis of NeighborWorks' loan portfolios resulted in assumed losses at the 'A+' level, ranging from a low 14.6% as of June 2023 to a high 34.3% as of December 2021. The higher assumed losses occurred in years when a larger percentage of the portfolio reported atypically weak performance or when unsecured loans lacked provisions we consider a mitigating risk. This somewhat coincides with years when NPAs were higher. Permanent loans accounted for about 30% of the balance outstanding as of June 2023 compared with 7% in December 2020 while the outstanding construction loan balance decreased, reflecting an intentional shift in lending recently. This composition could shift again by 2024; however, 2023 will be NeighborWorks' most active lending year with a particularly high demand for construction loans. This increase in lending aligns with its strategic goal to grow and diversify assets.

After the application of our loan-loss assumptions, NeighborWorks' net equity-to-total assets ratio was nearly 31.7% in fiscal 2022; this represents a reversal of the decreasing trend from the previous four years, which we attribute to two factors : an increase in equity as described above and a decrease in our assumed loan losses.

We view NeighborWorks' net equity-to-debt ratio as neutral in our analysis. It sufficiently matches the term and duration of assets and liabilities, in our opinion, with a fixed-rate loan portfolio and mostly fixed-rate debt outstanding. We think management is strategic in maintaining its debt profile and planning for when debt service payments are due; as of September 2023, maturing loan balance exceeds the amount of debt coming due each year until 2029 when no loans are scheduled to mature. Furthermore, management indicates its expectation to use certain equity-equivalent debt to fill potential long-term gaps, if needed.

Chart 1

Equity/Total assets versus net equity/total assets



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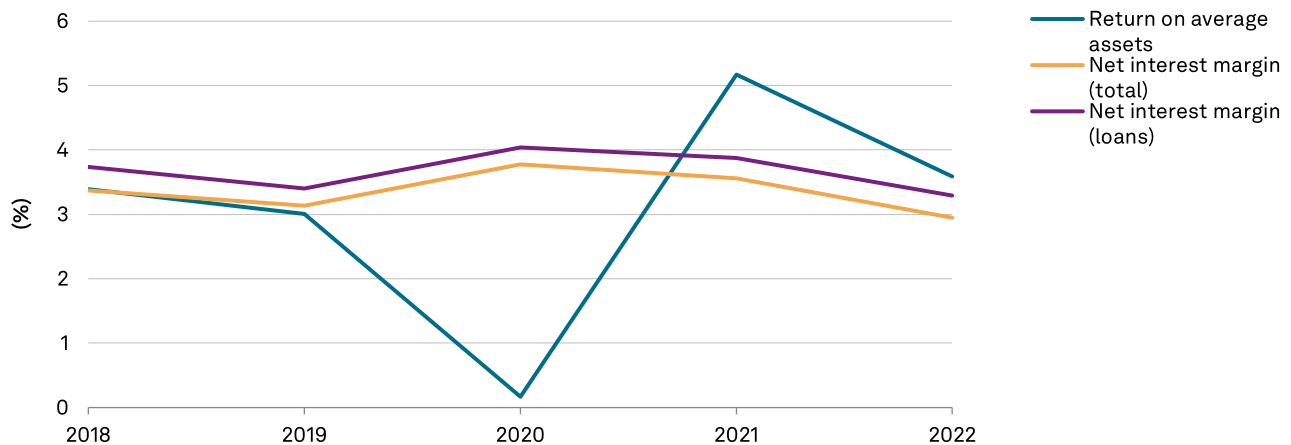
Profitability

In fiscal 2022, NeighborWorks' net income decreased from fiscal 2021, resulting in an ROA of about 3.6% and a five-year average of 3.1%, above our benchmark for the 'A' rating category but slightly below the median among other rated CDFIs. Conversely, NeighborWorks' NIM has outpaced its peers with a five-year average of about 3.4%. Loan interest income accounted for roughly 51% of total revenue in fiscal 2022, higher than the median for other rated CDFIs, which could receive more in grants or fee income.

The 3% reduction in gross loan balance outstanding between fiscal years 2021 and 2022 contributed to a 19% decrease in loan interest income received; total expenses increased by a modest 5% during that time, albeit net income decreased. NeighborWorks America contributed \$3 million in grants to NeighborWorks Capital in fiscal 2022, in line with the master investment agreement (expiring December 2025), which called for annual funds between \$1 million and \$5 million. Profitability had decreased in fiscal 2020 after the provision for loan losses increased by about \$3 million because of the uncertainty associated with COVID-19, but this has decreased since.

Chart 2

Profitability metrics



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Asset quality

NeighborWorks' total assets reached \$108.3 million in fiscal 2022, up from \$106.9 million in fiscal 2021, despite a decrease in gross loan balance outstanding. Over this time, the loan portfolio decreased slightly by 3% to \$98.4 million; it has since rebounded to hit a peak of \$104.7 million as of June 2023. Management attributes the year-over-year increase in total assets in fiscal 2022 to a 36% increase in short-term investments, including a capital magnet fund award.

In our opinion, asset quality is weaker than other rated CDFIs due largely to one construction loan that encountered challenges starting in 2020, which remained delinquent and on the watch list. In the second quarter of 2023, it converted this loan to permanent financing and received the investor's tax credit installment. While other loans became delinquent during the past five years, this loan represented a material portion of the portfolio balance outstanding. One reason this loan remained delinquent for multiple years is the strategic decision to prioritize the property's residents compared with foreclosing on the property and liquidating the asset. In response to its experiences with this loan, NeighborWorks reflected on its loan underwriting and portfolio monitoring and revised certain components as necessary. In our opinion, this demonstrates portfolio management strength.

NPAs were 10.3% of total loans in fiscal 2022 and averaged 6.1% between fiscal years 2018 and 2022. As of June 2023, they represented 1.5% of loans outstanding; we expect this ratio will likely remain well below the high from fiscal 2022 during the next few fiscal years. At the same time, NeighborWorks maintained loan loss reserves at 4.5% of total loans on a five-year average, above the median for its rated peers.

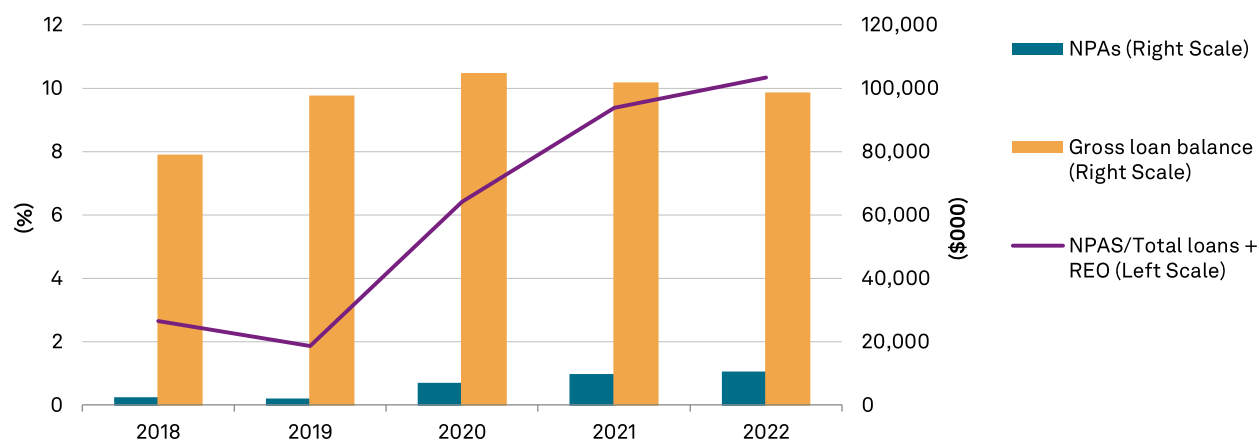
About half of loan balance outstanding as of June 2023 was for properties in California, Colorado, or Massachusetts; in December 2020, these three states accounted for 39% of loan balance outstanding. The balance of permanent loans increased to about 30% of the total in June 2023, up from 7% in fiscal 2020, while land acquisition loans remained

between 20% and 25% of the balance. Multifamily loans remain the largest segment of lending, accounting for 80% of the balance outstanding, while single-family for-sale properties account for 10%.

We view NeighborWorks' investment portfolio as generally low risk based on our review of its adopted investment management policy and requirement that maturities be no more than two years for most permitted investments, which largely include U.S. government securities. We find investment management policies and management to be strong, even if the value of marketable securities has remained below 1% of total assets.

Chart 3

Nonperforming assets



NPAs--Nonperforming assets.
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Liquidity

NeighborWorks, in our view, has strong liquidity to cover short-term financial needs. We consider asset liability management a primary mitigant to liquidity risk on the balance sheet. Approximately 86% of NeighborWorks' total assets is its loan portfolio and 12.6% were short-term investments, including cash and cash equivalents, in fiscal 2022. Compared with other rated CDFIs on a five-year average, NeighborWorks has more assets in loans and fewer in short-term investments; we think it adequately matches the duration of debt obligations and loans receivable.

NeighborWorks' liquidity policy requires three months' operating expenses held in cash available at all times, as well as an additional \$1 million in liquid assets, which it can invest according to its investment-management policy. In addition, we think it has strong access to external liquidity; at fiscal year-end 2022, \$76.5 million of undrawn lines of credit remained from several different financial institutions. This contributed to an available liquid assets-to-total loans outstanding ratio that is higher than some of its rated peers, which we view as neutral in our analysis.

Management

We view NeighborWorks' management as strong due to its experience and strategic senior leadership and board members. While most of the five-member leadership team joined the organization within the past five years, each one

brings significant sector experience and expertise to their roles. Thirteen independent board members govern NeighborWorks, one of whom is a representative for NeighborWorks America; at least one-third of board members are residents of the communities the organization serves.

We consider management's ability to resolve difficult situations during its operating history strong, including its strong financial management and strategic planning. NeighborWorks has exhibited an ability to adapt to changing circumstances and prepare resources to fulfill its social mission. It achieves this through the attraction of talent to senior leadership roles on the relatively recent turnover of CEO and CFO positions. In addition, with existing loans across 26 states and a total staff of about 19 full-time employees working mostly from the Maryland office, it could use third-party vendors for portfolio monitoring when it needs in-person visits; there are active conversations with borrowers, even in advance of when issues occur, such as the one construction loan in 2020.

Management indicates NeighborWorks is at an inflection point as it prepares for business-line expansion and strategic lending growth. Following a strategic plan that spanned 2019-2023, there is an effort to take 2024 to assess resources, including its planned consulting services, potential award of additional federal funding, and plan to become a member of Federal Home Loan Bank of Atlanta as another capital source. The strategy involves seeking affordable financing before staffing up to meet growth plans.

We think NeighborWorks lending is less affected by economic trends due to its exposure to various large states with diverse economies compared with those lenders in smaller geographic regions.

Table 1

Financial Ratio Analysis						
%	2018	2019	2020	2021	2022	5-year average
Capital adequacy						
Equity/total assets	49.9	44.9	43.2	48.2	51.1	47.5
Net equity/total assets	29.3	23.3	21.1	20.3	31.7	25.1
Equity/total debt	100.7	82.2	76.8	93.9	112.2	93.2
Net equity/total debt	59.1	42.8	37.4	39.6	69.6	49.7
Profitability						
Return on average assets	3.4	3.0	0.2	5.2	3.6	3.1
Net interest margin	3.4	3.1	3.8	3.6	2.9	3.4
Net interest margin (loans)	3.7	3.4	4.0	3.9	3.3	3.7
Asset quality						
NPAs/total loans + REO	2.7	1.9	6.4	9.4	10.3	6.1
Net charge-offs/average NPAs	0.0	0.0	19.7	9.2	0.0	5.8
Loan loss reserves/total loans	3.5	3.5	5.7	5.0	5.0	4.5
Liquidity						
Total loans/total assets	88.1	92.1	92.5	90.2	86.3	89.8
Short-term investments/total assets	11.7	7.6	7.0	9.4	12.6	9.6
Total investments/total assets	11.8	7.7	7.3	9.7	12.9	9.9

Table 2

Five-Year Trend Analysis					
	2018	2019	2020	2021	2022
Total assets	86,134,572	102,082,027	106,379,339	106,910,621	108,335,646
% change		19	4	0	1
Total debt	42,699,958	55,719,749	59,879,734	54,822,896	49,339,362
% change		30	7	(8)	(10)
Total equity	42,987,538	45,816,090	45,991,215	51,505,376	55,370,635
% change		7	0	12	8
Total net equity	25,239,732	23,834,833	22,396,529	21,682,542	34,355,133
% change		(6)	(6)	(3)	58
Revenues	6,771,028	7,713,396	8,324,976	10,106,308	8,706,186
% change		14	8	21	(14)
Expenses	3,953,597	4,854,844	8,149,851	4,592,147	4,840,927
% change		23	68	(44)	5
Net income	2,727,431	2,828,552	175,125	5,514,161	3,865,259
% change		23	2	1	(23)
Total Program MBS and loans	78,631,546	97,399,125	104,415,360	101,456,068	98,408,401
% change		24	5	(2)	(3)
Nonperforming assets	2,085,912	1,811,775	6,695,028	9,521,936	10,167,408
% change		(13)	270	42	7

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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