S&P Global
Ratings

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NeighborWorks Capital Corp., Maryland; General Obligation

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Long Term Rating	A+/Positive	Outlook Revised

Credit Highlights

- S&P Global Ratings revised its outlook to positive from stable and affirmed its 'A+' issuer credit rating (ICR) on NeighborWorks Capital Corp., Md.
- The outlook revision reflects the likelihood that NeighborWorks Capital's capital adequacy will remain above-average compared with that of similarly rated peers over the next two years as it executes its growth strategy, while other key credit factors could be in line with those of a higher rating level.

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 our ICR on NeighborWorks Capital include the organization's capital adequacy, profitability, and liquidity, and our view of management. The institution's near-term strategy includes increasing total assets and lending capacity by potentially increasing leverage on the balance sheet, trends that we believe will not materially weaken NeighborWorks Capital's key credit strengths. 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 Capital's:

- Financial strength, measured by about $60.2 million in equity and its net equity-to-assets ratio of nearly 38.5% in fiscal 2023 and five-year average of 27.8%, which we view as above-average relative to those of peers, despite more-limited funding sources than other rated community development financial institutions (CDFIs);
- Average profitability compared with peers, with return on average assets (ROA) of about 3.3% between fiscal years 2019 and 2023, but its five-year average net interest margin (NIM) of 3.4% exceeds that of its peers;
- Weaker-than-average asset quality compared with its peers, measured by a nonperforming-assets (NPAs)-to-total assets ratio averaging 6.1% between fiscal years 2019 and 2023 due largely to one sizable construction loan that encountered challenges starting in 2020, as well as loan loss reserves averaging 4.6%;
- Sufficient liquidity, measured by a total loans-to-total assets ratio averaging 87% over the past five years and short-term investments-to-total assets ratio averaging 12%, with about $66 million in undrawn external liquidity by fiscal year-end 2023, which NeighborWorks Capital plans to use for varying purposes based on their terms and costs; 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 align with its mission.

NeighborWorks Capital is a national nonprofit community development loan fund incorporated in 2000 in Colorado. 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 Capital operates under a five-year master investment agreement with NeighborWorks America, a congressionally chartered organization, 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 Capital operates independently, with none of its obligations guaranteed by NeighborWorks America.

Environmental, social, and governance

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

Outlook

The positive outlook reflects our view that NeighborWorks Capital will likely maintain above-average capital adequacy ratios as it proceeds with its growth strategy. Based on discussions with management and our analysis of the unaudited June 2024 financials, we expect net equity will remain above 20% on a five-year average, particularly if our loan loss assumptions remain consistent with our current analysis. We recognize that the five-year average asset quality will likely remain weaker than that of other rated CDFIs in the near term, particularly following higher delinquencies in fiscal years 2021 and 2022. At the same time, we believe NeighborWorks Capital's strategic debt management and maintenance of available liquidity will likely mitigate downward pressure on its rating and ultimately contribute to a credit profile that will be more in line with that of higher-rated peers during the two-year outlook period.

Downside scenario

We could consider a negative rating action, include a revision to a stable outlook, if NeighborWorks Capital increases 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, significantly reduced liquidity available to meet short-term needs, and material deterioration in loan performance could also be signs of credit weakness that lead us to consider a negative rating action.

Upside scenario

We could raise the rating if the net equity-to-assets ratio continues to exceed 25% in the near-term, 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 the CDFI's credit profile in-line with that of a higher rating level. We think NeighborWorks Capital's growth strategy could lead 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

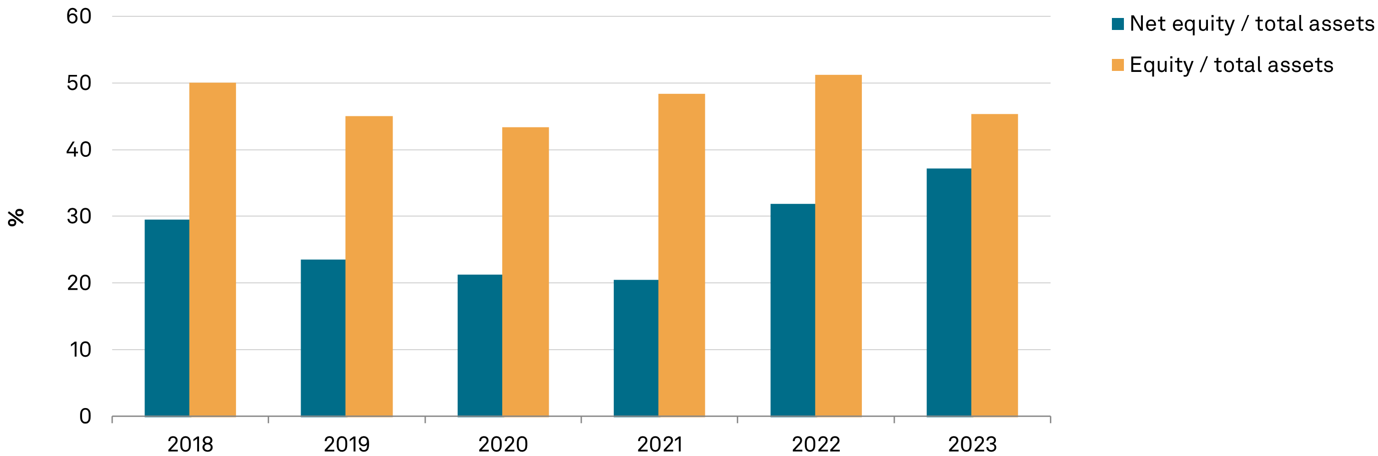
We consider NeighborWorks Capital's capital adequacy to be above other CDFIs' average based on a five-year average net equity-to-assets ratio of 27.8%. In fiscal 2023, NeighborWorks Capital increased its leverage as a strategy to fund additional loans, and this increase in debt outstanding outpaced that of the gross loan balance. Much of this new debt carried below-market interest rates or provided flexible financing sources. While equity as a percent of total assets decreased to about 45% from 51% in fiscal 2022, net equity increased because an improvement in loan portfolio characteristics led our assumed loan losses to decrease substantially. As of June 2024, total debt outstanding decreased slightly while the loan balance outstanding increased, leading to a modest increase in its equity-to-total assets ratio. While a slight weakening of capital adequacy ratios might result from NeighborWorks Capital's medium- and longer-term-capitalization initiatives, we believe these ratios will likely remain above-average when compared with those of other rated CDFIs and in line with the 'AA' rating category over the outlook period.

Our analysis of NeighborWorks Capital's loan portfolio as of Dec. 31, 2023, resulted in assumed losses at the 'A+' level of 12.2%, down from the losses that we assumed on the prior year's portfolio, which had more loans with weaker performance or unmitigated repayment risk. As of March 2024, the portfolio characteristics were even stronger than December 2023. Permanent loans have accounted for an increasing share of the portfolio, up to 35% in December 2023 compared with 28% for the same month in 2022 and 7% in 2020; the existing construction loan balance decreased over this period. This reflects an intentional shift in lending, which we expect will continue in the near term.

We view NeighborWorks Capital's 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 March 2024, maturing loan balance exceeds the amount of debt coming due each year until 2029 when no loans are currently 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



Source: S&P Global Ratings.

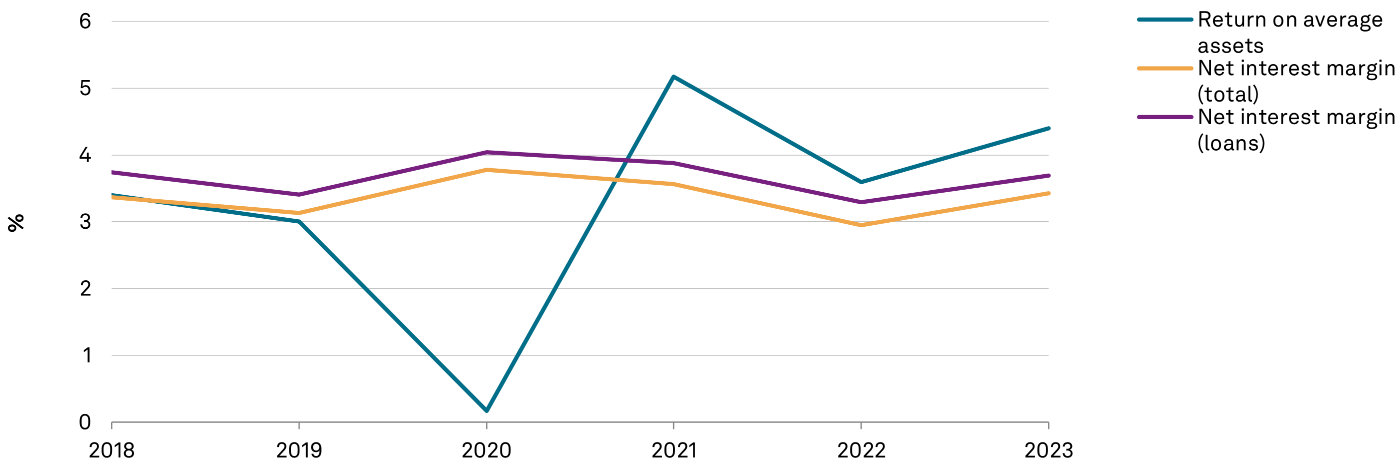
Profitability

An significant increase in investment income during fiscal 2023 contributed to an increase in net income, resulting in an ROA of about 4.4% and a five-year average of 3.3%, above our benchmark for the 'A' rating category but slightly below the median among other rated CDFIs. Conversely, NeighborWorks Capital's NIM has outpaced its peers with a five-year average of about 3.4%. As it executes on the growth strategy that began in 2023, NeighborWorks Capital has taken steps to attract more philanthropic capital than in the past, such as hiring a full-time chief growth officer with a focus on raising grant revenue. While investment income might decrease in the near term, attracting more grant revenue could have a positive effect on profitability and contribute to the expansion of the organization's lending.

The 6% increase in gross loan balance outstanding between fiscal years 2022 and 2023 contributed to a 26% increase in loan interest income received; total expenses increased by a modest 4% during that time. NeighborWorks America contributed $3 million in grants to NeighborWorks Capital in fiscal 2023, in line with the master investment agreement (expiring December 2025).

Chart 2

Profitability metrics



Source: S&P Global Ratings.

Asset quality

NeighborWorks Capital's total assets reached a high of $133.2 million in fiscal 2023, up from $108.3 million in fiscal 2022. This increase followed the sale of certain loans through the Schwab permanent loan fund, an investment made by a financial institution at an interest rate well-below market, and growth in the existing loan portfolio.

In our opinion, asset quality is weaker than that of other rated CDFIs, but improved significantly in fiscal 2023 compared with the previous three years--NPAs were 2.7% of total assets in fiscal 2023, with a five-year average of 6.1%. At the same time, NeighborWorks Capital maintained loan loss reserves at 4.6% of total loans on a five-year average, above the median for its rated peers.

While there remained a $1.5 million mini-permanent loan on non-accrual status by the end of fiscal 2023, this is down from $9.4 million from fiscal 2022 because a large, delinquent construction loan converted to permanent and paid off. That loan had remained delinquent for multiple years because of 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 Capital reflected on its loan underwriting and portfolio monitoring and revised certain components as necessary. In our opinion, this demonstrates portfolio management strength.

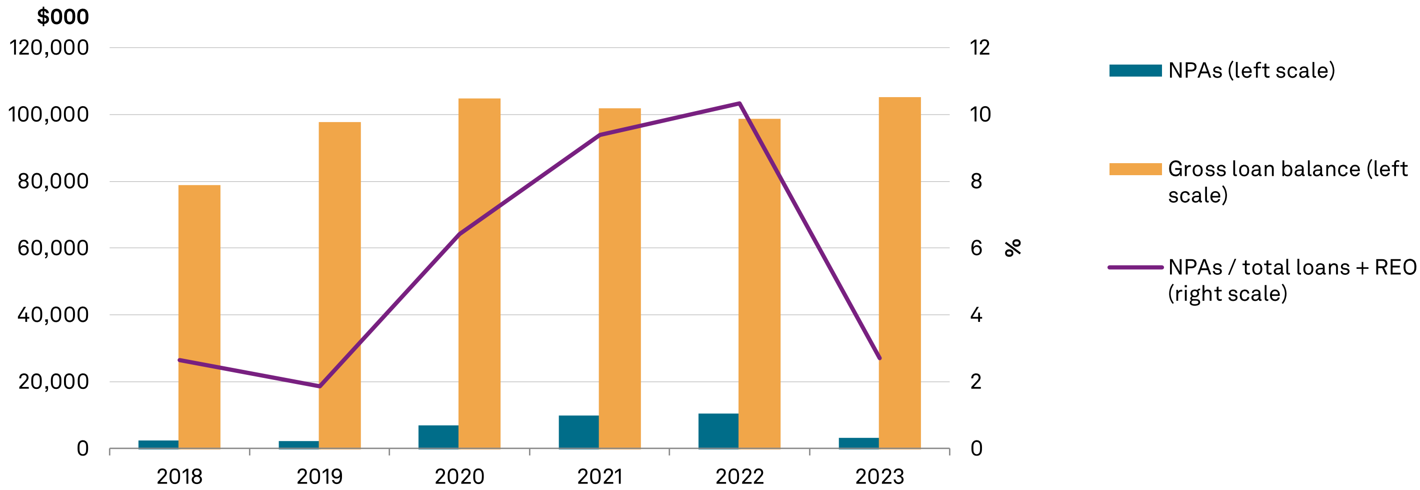
At the same time, management has adapted its loan underwriting and requirements in response to larger recent nonaccruals, which had a material effect on asset quality given the portfolio size; therefore, we think asset quality will likely continue improving during the outlook period.

More than half of loan balance outstanding as of March 2024 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 34% of the total in March 2024, up from 7% in fiscal 2020, while land acquisition loans remained between 18% and 25% of the balance. Multifamily loans remain the largest segment of lending, accounting for more than 80% of the balance outstanding, while single-family for-sale properties account for less than 10%.

We view NeighborWorks Capital's 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.

Chart 3

Nonperforming assets



NPA--Nonperforming asset. REO--Real estate owned. Source: S&P Global Ratings.

Liquidity

NeighborWorks Capital, 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. Following the increase in short-term assets from factors mentioned above, approximately 76% of NeighborWorks Capital's total assets were its loan portfolio and 24% were short-term investments, including cash and cash equivalents, in fiscal 2023, a slight shift from the previous year. Compared with other rated CDFIs on a five-year average, NeighborWorks Capital has more assets in loans and fewer in short-term investments; we think it adequately matches the duration of debt obligations and loans receivable.

In addition, we think it has strong access to external liquidity; at fiscal year-end 2023, $62.5 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 that of some of its rated peers, which we view as neutral in our analysis. NeighborWorks Capital's 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.

Management

We view NeighborWorks Capital's 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 Capital, 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 Capital 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 24 states and a total staff of about 20 full-time employees working mostly from the Maryland office, NeighborWorks Capital could use third-party vendors for portfolio monitoring when it needs in-person visits; there are active conversations with borrowers when they encounter difficulty or repayment methods are strained.

NeighborWorks Capital is undergoing its planned business-line expansion and strategic-lending growth. In establishing a scalable capital model for the future, NeighborWorks Capital recently became a member of the Federal Home Loan Bank of Atlanta, which offers a facility that members can use as another capital source, and plans to engage new investors.

We think NeighborWorks Capital lending is less affected by economic trends due to the organization's 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	2023	Five-year average
Capital adequacy							
Equity/total assets	49.9	44.9	43.2	48.2	51.1	45.2	46.5
Net equity/total assets	29.3	23.3	21.1	20.3	31.7	37.0	26.7
Equity/total debt	100.7	82.2	76.8	93.9	112.2	87.6	90.6
Net equity/total debt	59.1	42.8	37.4	39.6	69.6	71.7	52.2
Profitability							
Return on average assets	3.4	3.0	0.2	5.2	3.6	4.4	3.3
Net interest margin	3.4	3.1	3.8	3.6	2.9	3.4	3.4
Net interest margin (loans)	3.7	3.4	4.0	3.9	3.3	3.7	3.7
Asset quality							
NPAs/total loans + REO	2.7	1.9	6.4	9.4	10.3	2.7	6.1
Net charge-offs/average NPAs	0.0	0.0	19.7	9.2	0.0	0.0	5.8
Loan loss reserves/total loans	3.5	3.5	5.7	5.0	5.0	3.8	4.6
Liquidity							
Total loans/total assets	88.1	92.1	92.5	90.2	86.3	75.7	87.3
Short-term investments/total assets	11.7	7.6	7.0	9.4	12.6	23.5	12.0

Table 1

Financial ratio analysis (cont.)

%	2018	2019	2020	2021	2022	2023	Five-year average
Total investments/total assets	11.8	7.7	7.3	9.7	12.9	23.9	12.3

NPA--Nonperforming asset. REO--Real estate owned.

Table 2

Five-year trend analysis

	2018	2019	2020	2021	2022	2023
Total assets	86,134,572	102,082,027	106,379,339	106,910,621	108,335,646	133,184,842
% change	15.4	18.5	4.2	0.5	1.3	22.9
Total debt	42,699,958	55,719,749	59,879,734	54,822,896	49,339,362	68,717,013
% change	25.7	30.5	7.5	-8.4	-10.0	39.3
Total equity	42,987,538	45,816,090	45,991,215	51,505,376	55,370,635	60,180,867
% change	6.8	6.6	0.4	12.0	7.5	8.7
Total net equity	25,239,732	23,834,833	22,396,529	21,682,542	34,355,133	49,238,303
% change		-5.6	-6.0	-3.2	58.4	43.3
Revenues	6,771,028	7,713,396	8,324,976	10,106,308	8,706,186	10,342,311
% change	-5.6	13.9	7.9	21.4	-13.9	18.8
Expenses	3,953,597	4,854,844	8,149,851	4,592,147	4,840,927	5,031,975
% change	24.4	22.8	67.9	-43.7	5.4	3.9
Net income	2,727,431	2,828,552	175,125	5,514,161	3,865,259	5,310,336
% change	-31.7	3.7	-93.8	3048.7	-29.9	37.4
Total program MBS and loans	78,631,546	97,399,125	104,415,360	101,456,068	98,408,401	104,778,184
% change	12.8	23.9	7.2	-2.8	-3.0	6.5
Nonperforming assets	2,085,912	1,811,775	6,695,028	9,521,936	10,167,408	2,839,218
% change		-13.1	269.5	42.2	6.8	-72.1

MBS--Mortgage-backed securities.

Related Research

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