## Information on NADB

*The information on NADB included in this section is not exclusive and potential Holders should not rely solely on such information, but should consider all information provided in this Prospectus, including the documents annexed hereto.*

### North American Development Bank

NADB is a binational development financing institution established on January 1, 1994 to finance environmental infrastructure projects in the U.S.-Mexico border region. Communities eligible to receive NADB financing must be located within 100 kilometers (62 miles) north and within 300 kilometers (186 miles) south of the U.S.-Mexico borderline (the **border region**), which includes thirty-seven counties within the U.S. states of Texas, New Mexico, Arizona and California and 213 municipalities within the Mexican states of Tamaulipas, Nuevo León, Coahuila, Chihuahua, Sonora and Baja California with a total population of approximately 26.23 million for the border region. NADB was created under the auspices of the North American Free Trade Agreement (**NAFTA**) and operates under the Agreement between the Government of the United States of America and the Government of the United Mexican States concerning the Establishment of a Border Environment Cooperation Commission and a North American Development Bank, as amended (the **Charter**). The Border Environment Cooperation Commission (**BECC**) was created to evaluate and certify the technical feasibility and environmental impact of, and elicit public participation with respect to, all infrastructure projects to be financed by NADB. NADB and the BECC are each governed by a common Board of Directors comprised of, among others, federal government officials from each country. See "Administration and Governance – Board of Directors."

Together with the BECC, NADB works to develop integrated, sustainable and financially sound projects with broad community support in a framework of close cooperation and coordination between Mexico and the United States of America. NADB's activities are directed towards enhancing the affordability, financing, long-term development and effective construction of infrastructure that promotes a clean, healthy environment for the citizens of the border region.

The United States of America and Mexico are the sole members of NADB (the **"member countries"**). NADB's total authorized capital is USD 6 billion, consisting of USD 460 million in paid-in capital and USD 2.61 billion in associated callable capital (available to NADB, subject to appropriation by the U.S. and Mexican Congress, respectively). As of December 31, 2016, NADB has received all paid-in capital contributions from its original subscription. During 2016, the U.S. and Mexican governments each subscribed an additional 150,000 shares of capital stock with a par value of USD 10,000 per share for a total additional subscription of USD 3 billion, subject to the necessary legislation and availability of appropriations. The obligations of the United States of America and Mexico, respectively, to make payment of the callable portion of their subscriptions for capital shares of NADB are independent, and the failure of one member country to make payment on any such call would not excuse the other member from its obligations.

Pursuant to NADB's Charter, 10% of NADB's original capital subscription was set aside to fund domestic community adjustment and investment programs in each country. NADB has fully disbursed the funds for the Mexican domestic program, but continues to administer the funds allocated to the U.S. domestic program, the Community Adjustment and Investment Program (**USCAIP**). See "Business Operations – The Domestic Programs." USCAIP is funded entirely from this allocated capital and any net income earned by the program and its profits, losses, expenses and disbursements do not affect NADB's retained earnings or paid-in capital nor would any USCAIP net income be available to support NADB's obligations, including those under any of NADB's debt securities or other borrowings.

This Prospectus contains forward looking statements which may be identified by such terms as "anticipates", "believes", "intends", "plans", or words of similar meaning. Such statements involve a number of assumptions and estimates that are based on current expectations, which are subject to risk and uncertainties beyond NADB's control. Consequently, actual future results could differ materially from those currently anticipated.

NADB's principal office is located at 203 South St. Mary's, Suite 300, San Antonio, Texas 78205, United States of America.

## The Charter

NADB's Charter sets forth its purpose and functions as a development financing bank and its capital structure and organization. The Charter outlines NADB's permissible financing activities and prescribes limitations on these activities and NADB's operations. The Charter also establishes the status, immunities and privileges of NADB as a multilateral institution and provides for the suspension and termination of NADB's operations. The Charter may be amended by agreement of the member countries. The Charter entered into force on 1 January 1994, and was amended by the U.S. and Mexico on 6 August 2004.

The full text of the Charter is available on NADB's website at:
http://www.nadb.org/pdfs/publications/Charter_2004_Eng.pdf

## Purpose

Pursuant to Chapter II, Article I, of the Charter, the purpose of NADB

(a) shall be to provide financing for projects certified by the Board of Directors. These projects help preserve, protect, and enhance the environment of the border region in order to advance the well-being of the people of the United States and Mexico.

(b) shall be to provide financing endorsed by the United States, as appropriate, for community adjustment and investment in support of the purposes of the North American American Free Trade Agreement.

(c) Shall be to provide financing endorsed by Mexico, as appropriate, for community adjustment and investment in support of the purposes of the North American Free Trade Agreement.

## Legal Status, Immunities and Privileges

The following is a summary of the principal provisions of the Charter relating to the legal status, immunities and privileges of NADB in the territories of its member countries:

NADB possesses juridical personality with full capacity to contract, acquire and dispose of immovable and movable property and to institute legal proceedings. Judicial proceedings may be brought against NADB only in a court of competent jurisdiction in the territories where NADB has an office, has appointed an agent for service of process or has issued or guaranteed securities.

Assets and property of NADB are immune from legal process and cannot be subject to any seizure, attachment, or other expropriation or foreclosure prior to delivery of final judgment against NADB. In addition, NADB's Directors, Managing Director and Deputy Managing Director, officers and staff employees have immunity from legal process with respect to acts performed by them in their official capacity (except when NADB has expressly waived this immunity). These individuals are also afforded the same privileges in respect of traveling facilities as are accorded by each member country to representatives, officials and employees of comparable rank of the other member country and, when not local nationals, the same immunities from immigration restrictions, alien registration requirements and national service obligations and the same facilities as are accorded by each member country to the representatives, officials, and employees of comparable rank of the other member country.

NADB, its property, other assets, income, and the operations it carries out pursuant to the Charter are also immune from all taxation and from all customs duties, including any obligation relating to the payment, withholding or collection of any tax or customs duty. No tax may levied on or in respect of salaries and emoluments paid by NADB to officers or staff who are not U.S. nationals.

## Independent Auditors

The financial statements of NADB as of December 31, 2016 and 2015 and for the years then ended, included in this Prospectus, have been audited by Ernst & Young LLP, independent auditors, as stated in their report included in this Prospectus. Their address is 100 West Houston Street, Suite 1700, San Antonio, Texas 78205, United States of America.

## Business Operations

### General

NADB offers loans to project sponsors to finance environmental infrastructure within the U.S.-Mexico border region. Loans may be made to public and private borrowers. In its early years of operation, the vast majority of loans were made to states and local municipalities (**governmental borrowers**). In recent years, NADB has worked more with private borrowers due to their heavier involvement in newly addressed sectors such as renewable energy. Consistent with NADB's risk management philosophy, private borrower lending is subject to more stringent analysis and credit enhancement requirements. The Bank also supports public-private partnerships as a sound means of financing public infrastructure, especially for water supply and wastewater treatment projects. In most cases these partnershipsare implemented through a build-operate-transfer (BOT) agreement, where the private contractor is the borrower and the municipality or utility serves as the source of payment and/or guarantor.

The following table sets forth certain information on the Bank's total outstanding loan portfolio:

**Outstanding Loan Portfolio, by Borrower Type**
(amounts in U.S.$ Million)

| | 2016 | | 2015 | | 2014 | |
|---|---|---|---|---|---|---|
| Governmental Borrowers | $288.31 | 20.43% | $305.59 | 23.07% | $319.77 | 26.98% |
| Private Borrowers | 1,032.76 | 73.18 | 927.23 | 69.99 | 774.67 | 65.34 |
| Public-Private Borrowers | 90.23 | 6.39 | 91.96 | 6.94 | 91.07 | 7.68 |
| **Total Outstanding Loan Portfolio(1)** | **$1,411.30** | **100.00%** | **$1,324.78** | **100.00%** | **$1,185.51** | **100.00%** |

(1) Excludes loans made under USCAIP.

Unless otherwise specified, all references to the Bank's outstanding loan portfolio in this Prospectus have been calculated before taking into account any allowances for loan losses, unamortized loan fees, the effect of foreign currency exchange rate adjustments, the fair value of hedged items, and any loans (and any associated reserves) made under USCAIP. See "—The Domestic Programs—U.S. Domestic Program."

In certain limited circumstances and under well-defined criteria, the Bank can make available grant funds to its borrowers and certain other eligible grantees. The Bank's largest grant program, the Border Environment Infrastructure Fund (**BEIF**), is fully funded by the EPA and administered by the Bank. Currently, the Bank has only two active grant programs, the Community Assistance Program (**CAP**) and the Technical Assistance Program (**TAP**), funded by its retained earnings. See "—Grants."

Since its inception to December 31, 2016, the Bank has contracted a total of $2.76 billion in infrastructure development financing, consisting of $2.02 billion (73.19%) in loans and $738.32 million (26.81%) in grants, to finance 231 BECC-certified projects estimated to cost a total of $8.24 billion to build. Of that amount, the Bank has disbursed over $2.65 billion to project sponsors for the implementation of 216 projects.

## Business Objectives

The Bank's original mandate was to finance and facilitate the development of environmental infrastructure projects aimed at creating and sustaining drinking water supplies and developing wastewater treatment and municipal solid waste management facilities. These sectors continue to comprise an important component of the Bank's financing efforts. In 2000, the Bank's mandate was expanded to encompass financing in other environmental sectors that have health and/or environmental benefits for the residents of the border region, including air quality, clean energy, energy efficiency, and public transportation. Since the expansion of the Bank's mandate, the Bank's loan portfolio has been diversified to include projects such as street paving, wind farms, solar parks, low emission buses, and landfill gas-to-energy (LGE) projects.

### Recent Lending Activity

In 2016, the Bank signed loan agreements totaling $146.77 million covering 4 projects, as compared to $178.26 million signed in 2015 covering 7 projects, and the Bank disbursed $136.25 million in loan proceeds to borrowers over the course of 2016, as compared to $249.56 million in 2015. In 2016, the Bank received a total of $49.73 million in principal repayments, as compared to $110.30 million in 2015.

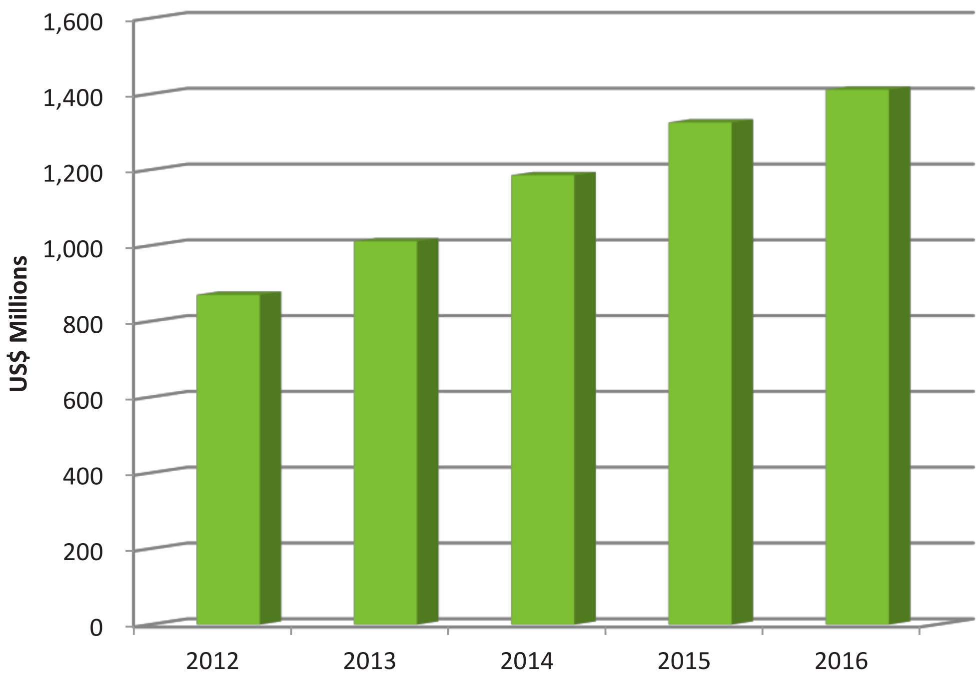
The following table sets forth certain information on the Bank's total outstanding loan portfolio since inception:

**Outstanding Loan Portfolio**
(in U.S.$ Million)

| | As of December 31, 2016 | As of December 31, 2015 |
|---|---|---|
| Total disbursements made | $ 1,961.63 | $ 1,825.38 |
| Total principal repayments received | $ (550.33) | $ (500.60) |
| Outstanding loan portfolio (at period end) | $ 1,411.30 | $ 1,324.78 |
| Total contracted loans | $ 2,020.15 | $ 1,877.19 |
| Signed commitments, not yet disbursed | $ 58.52 | $ 51.82 |

The Bank's outstanding loan portfolio equaled $1,411.30 million and $1,324.78 million as of December 31, 2016 and December 31, 2015, respectively. The Bank's outstanding loan portfolio has grown roughly 62.22% from its balance at the end of 2012. This represents an average compound annual growth rate of 12.86% for the period from December 31, 2012 to December 31, 2016.

**NADB's Outstanding Loan Portfolio (in U.S.$ Millions)**




During 2016, the Bank provided financing for one wind energy project, one air quality project, and one public transportation project, along with a financing increase to an existing water project. As of December 31, 2016, water supply and wastewater projects constituted 12.20% of the Bank's outstanding loan portfolio, storm drainage projects 3.99%, air quality projects 7.35%, public transportation projects 2.26%, water conservation projects 0.52%, clean energy wind projects 50.10%, clean energy solar projects 20.66%, clean energy other projects 0.34%, and basic urban infrastructure projects 2.58%.

The following table sets forth certain information on the Bank's total outstanding loan portfolio:

**Outstanding Loan Portfolio, by Project Type**
(amounts in U.S.$ Million)

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | **2012** | **2013** | **2014** | **2015** | **2016** |
| **Outstanding Loan Portfolio** | $869.98 | $1,011.21 | $1,185.51 | $1,324.78 | $1,411.30 |
| **Project Type (as a percentage of the total portfolio):** | | | | | |
| Water and Wastewater | 15.29% | 15.71% | 15.88% | 13.68% | 12.20% |
| Storm Drainage | 7.95 | 6.53 | 5.30 | 4.50 | 3.99 |
| Air Quality | 15.38 | 11.73 | 11.49 | 8.36 | 7.35 |
| Solid Waste | 0.23 | – | – | – | – |
| Basic Urban Infrastructure | 3.07 | 2.87 | 1.98 | 2.78 | 2.58 |
| Public Transportation | – | – | – | 0.28 | 2.26 |
| Water Conservation | – | – | – | 0.56 | 0.52 |
| Clean Energy | | | | | |
| Solar | 18.39 | 26.47 | 28.81 | 22.84 | 20.66 |
| Wind | 39.49 | 36.58 | 36.32 | 46.68 | 50.10 |
| Other | 0.20 | 0.11 | 0.22 | 0.32 | 0.34 |
| Clean Energy (Total) | 58.08 | 63.16 | 65.35 | 69.84 | 71.10 |

In the first quarter of 2017, the Bank entered into two new credit agreements to provide approximately $48.80 million in loans to private borrowers. The largest of these loans relates to a wind energy project located in the U.S. for a total of $37.80 million.

## Lending Policies

*General*

The Bank's lending operations conform to certain practices designed to ensure that loans are made to financially sound entities and that funds are utilized as intended to implement technically and economically viable projects. These practices are described in "Box 1: Lending Operations Practices" below. The Bank negotiates individual loan agreements according to these principles and the needs of a particular borrower or project. Loan disbursements are made subject to the fulfillment of conditions set forth in each individual loan agreement.

Loans to governmental borrowers in Mexico are made through the *Corporación Financiera de América del Norte, S.A. de C.V. SOFOM E.N.R* (**COFIDAN**), a multi-purpose financial institution established by the Bank in 1999 to facilitate lending activities in the Mexican territory. COFIDAN is a consolidated subsidiary owned 99.90% by the Bank and 0.10% by the Mexican government. Of the Bank's total outstanding portfolio of $1,411.30 million as of December 31, 2016, 34 loans totaling $222.08 million were contracted through COFIDAN.

Box 1: Lending Operations Practices

**(1) In general, the Bank makes loans to governmental and private borrowers for environmental infrastructure projects intended to prevent, control or reduce environmental pollutants, protect flora and fauna, improve human health, and promote sustainable development in the U.S.-Mexico border region.**

**(2) All projects financed by the Bank must be certified by the BECC as meeting certain technical, environmental and public participation criteria, and must be located within the border region. Projects located outside the border region may be approved for loan financing if the Board determines the project would remedy a transboundary environmental or health problem.**

**(3) Project sponsors must submit a detailed proposal to the Bank specifying the technical, economic and financial feasibility of the project.**

**(4) In making loans, the Bank evaluates the borrower's ability to repay its obligations in accordance with the applicable loan repayment schedule. In making this determination, the Bank generally considers the loan payment mechanism, as well as the capacity of the borrower and/or project to generate sufficient revenues through various sources of cash flows to service its debt, the characteristics of the individual borrower and the nature and size of the project being financed.**

**(5) The Bank usually requires additional security arrangements, guarantees or sources of repayment or additional equity support to ensure repayment of the obligation.**

**(6) Loans may be extended with limited recourse to the cash flows from the operations of the project and its assets and/or full recourse to the project sponsor or a guarantor if necessary to provide reasonable assurance of repayment. Project finance transactions are typically further secured by market standard credit enhancements, such as relevant reserve accounts, letters of credit, manufacturer warranties and guarantees.**

**(7) To ensure that loan proceeds are used appropriately by project sponsors, the Bank monitors project construction and completion.**

The Bank may act as a sole lender or co-finance projects with other public or private financiers, depending upon the size and risk profile of the project. In its early years, almost all of the Bank's co-financed projects were through a consortium with other governmental lenders, mainly in the wastewater sector. More recently, the Bank has participated in several project finance transactions with a co-financing structure where the Bank will be repaid *pari passu* and share collateral pro-rata with the other lenders. The Bank is looking to participate in more co-financing structures of this nature, which will allow it to support larger projects while limiting its credit exposure.

In terms of borrowers, the loan portfolio is divided into three categories: public, private or public-private. In the latter case, a private company is the direct borrower, but the source of payment and/or guaranty is a public utility or local government and the Bank has recourse to both the private and public entity. As of December 31, 2016, $1,032.76 million or 73.18% of the outstanding portfolio was financed to private borrowers, $288.31 million or 20.43% financed to public borrowers and the remaining $90.23 million or 6.39% financed to public-private borrowers.

*Collateral and Security*

The Bank's core lending principles include an emphasis on risk aversion and a commitment to a strong payment structure. As of December 31, 2016, approximately 56.18% of the loans in the Bank's outstanding portfolio (measured by principal amount) are with Mexican borrowers and 43.82% are with U.S. borrowers. Of the Bank's loans to Mexican borrowers, approximately 36.01% are backed by federal tax revenues that have been pledged to an irrevocable trust for the benefit of the Bank or that are held by the state government and have been pledged as credit support pursuant to a mandate contract, which serves as a source of payment and/or guaranty to service the loan. All of the Bank's loans to U.S. governmental borrowers are structured as revenue bonds and are backed by specific system revenues.

Loans to private borrowers are secured by borrower cash flows, project cash flows or other dedicated sources of revenue. The Bank may require additional collateral from its borrowers, such as other project assets, including a mortgage on fixed assets (land, plant and other buildings), personal and corporate guarantees, a mortgage on or security interest in movable assets (equipment and other business assets), a pledge of a project sponsor's share in the project or the assignment of the sponsor's insurance policies and other contractual benefits. Where appropriate, the Bank may also require these types of credit support from its governmental borrowers.

With respect to clean energy projects, the source of loan payments is typically from take-or-pay purchase agreements between the project companies and utilities or large, well-positioned companies as off-takers. These projects are built by well-known developers. The Bank is focused on projects where the utilities are the sole provider of energy in a community, thus mitigating the market risk.

The Bank requires a customary debt service coverage ratio on all its loans. The debt service coverage ratio is the ratio of the total annual net cash flow divided by the total fixed obligations of a project. A minimum debt service coverage ratio of 1.0x is required for loans with a pledge of tax revenues. For all other loans, a minimum debt service coverage ratio of 1.2x is generally required. This requirement is intended to ensure that borrowers have sufficient cash flows available to cover the required debt service of NADB loans. In addition, for loans not secured by a pledge of tax revenues, the Bank generally requires borrowers to maintain a debt service reserve of between two months and twelve months of scheduled debt service, based on project risk mitigation requirements and prudent practices.

Lastly, the Bank usually requires a guarantee of the principal and interest payments under the loan by the borrower and limited or general guarantees from project sponsors, borrowers, equity investors or other relevant parties to guarantee the technical or financial performance and project completion.

*Lending and Borrowing Limits*

To ensure the Bank has capital resources sufficient to meet its financing activities and obligations, the Bank is subject to certain lending limits. Under its Charter, the total amount of the Bank's outstanding loans (including guarantees) may not exceed, at any time, the total amount of the Bank's paid-in and callable capital (not including the 10% allocated for USCAIP), plus unimpaired reserves and undistributed surplus. As of December 31, 2016, the total amount of the Bank's paid-in and callable capital (not including the 10% allocated for USCAIP) was $2.77 billion and its unimpaired reserves and undistributed surplus was $159.60 million, for a resulting total loan limit of $2.93 billion.

In addition, in May 2013, the Bank adopted a new debt limit policy to ensure that the total principal amount of the Bank's outstanding debt shall not at any time exceed the sum of the callable portion of the Bank's subscribed capital shares, plus the minimum liquidity level required by the Bank's liquidity policy. Under the debt limit policy, the Managing Director shall inform the Board when he or she reasonably estimates that the Bank's outstanding debt will reach 80% of the subscribed callable capital within the following six-month time period. By establishing a maximum amount of debt that the Bank can borrow to support its loan portfolio and liquidity requirements, the Bank seeks to maintain its total debt obligations within the limits of its capacity to honor them, even during a period when the Bank may face constraints in accessing the debt markets. As of December 31, 2016, the Bank has a total debt outstanding of $1,187.50 million, or 46.41% of the policy debt limit of $2.56 billion. The Bank also has an annual borrowing program authorized by its Board of Directors. For the 2017 fiscal year, the Bank is authorized to borrow up to $910.00 million either directly or indirectly through third party banks or by issuing debt.

As a prudential measure, the Bank imposes additional borrowing limits on a per obligor and per project basis. The Single Obligor Limit (**SOL**) provides that the maximum allowable credit exposure, net of disbursements repaid and any financing cancellations, on a per obligor and per project basis is limited to 20% of the Bank's funded unimpaired paid-in capital (i.e., paid-in capital not otherwise dedicated to a specific program or investment), plus the amount of undesignated retained earnings, the special reserve, and the capital preservation reserve. The maximum allowable credit exposure on a per obligor and per project basis may be increased to 30% of the Bank's funded unimpaired paid-in capital, plus the amount of undesignated retained earnings, the special reserve, and the capital preservation reserve if (i) the loan is to a state (or political subdivision thereof) and constitutes a general obligation of the state (or political subdivision thereof), (ii) the obligor provides marketable collateral to secure its loans or (iii) payments on the loan are made through a Mexican municipal or state irrevocable trust. As of December 31, 2016, the Bank had a SOL of $106.09 million (based on the 20% limit) and $159.13 million (based on the 30% limit for certain qualifying loans). The SOL decreases the maximum limit of potential credit risk exposure to a single obligor or single project, thereby fostering diversification in the loan portfolio, while still accommodating increases in the limit as the Bank's capacity to absorb unexpected losses increases.

NADB may only provide financing for up to 85% of a project's eligible costs. The remainder of the funding typically comes from project sponsors or other private entities in the form of equity contributions or other loans. Under the Bank's lending policies, eligible project costs include the acquisition of land and buildings, site preparation and development, design, construction, reconstruction, rehabilitation, improvement, the acquisition of necessary machinery and equipment, legal, finance and development costs, interest during construction, contingency or reserve funds, customs and other duties and other incidental costs approved by NADB.

*Currently Available Loan Terms*

NADB's loans generally are offered at market rates. Market rate loans represented 100% ($146.77 million) of the new loans contracted by the Bank in 2016.

On a limited basis and under stringent eligibility criteria, the Bank has in past periods also offered subsidized interest rate (**LIRF**) lending. No new LIRF loans have been made since 2007. Accordingly, the LIRF program was terminated in May 2013. As of December 31, 2016, LIRF loans accounted for 2.81% ($39.68 million) of the Bank's loan portfolio.

The following table provides the composition of the Bank's total outstanding loan portfolio with respect to market rate loans and LIRF loans as of December 31, 2014, 2015 and 2016.

**Outstanding Loan Portfolio, by Loan Type**
(amounts in U.S.$ Million)

| | Total Outstanding Loan Portfolio[(1)] | Market Rate Loans | % of Total Portfolio | LIRF Loans[(2)] | % of Total Portfolio |
|---|---|---|---|---|---|
| As of December 31, 2014 | $ 1,185.51 | $1,138.70 | 96.05% | $46.81 | 3.95% |
| As of December 31, 2015 | 1,324.78 | 1,281.60 | 96.74 | 43.18 | 3.26 |
| As of December 31, 2016 | 1,411.30 | 1,371.62 | 97.19 | 39.68 | 2.81 |

(1) Excludes loans made under USCAIP.
(2) Since November 2007, there have been no new approvals of loans under the LIRF program, although $9.92 million of LIRF loans were approved prior to November 2007 and contracted in 2008. The LIRF program was terminated in May 2013.

Loans are generally offered at fixed rates although variable rates are also available. Loans can be structured with monthly, quarterly or semi-annual payments with maturities of up to 25 years. For U.S. borrowers, loans are available in U.S. dollars. For Mexican borrowers, loans are available in Mexican pesos or in U.S. dollars if the project generates a U.S. dollar cash flow. For loans made in Mexican pesos, the Bank seeks to fully hedge exchange rate risk through cross-currency swaps. As of December 31, 2016, 37.33% of the outstanding balance of the Bank's loans were in pesos. For information on the Bank's currently available market rate loan terms and applicable fees see "Box 2: Currently Available Market Rate Loan Terms" below.

**Box 2: Currently Available Market Rate Loan Terms[(1)]**

| | |
|---|---|
| **Base Rate** | Available base rates include the yield on U.S. treasury securities, London Interbank Offered Rate ("LIBOR"), TIIE rate[(2)], or any other U.S. dollar ("USD") or Mexican peso ("MXN") reference rate, depending on the terms of the loan.[(3)] |
| **Administrative Margin[(4)]** | Based on the aggregate principal loan amount of:<br>• Less than $5 million: 100–150 basis points ("bps")<br>• Greater than $5 million but less than $17 million: 60–150 bps<br>• Greater than $17 million but less than $50 million: 40–150 bps<br>• Greater than $50 million: 25–150 bps |
| **Risk Exposure Spread[(5)]** | 0–400 bps[(6)] |
| **Commitment Fee** | 0.75% per annum on the undisbursed balance of the loan |

(1) In lieu of a portion of the basis points payable as interest on the loan, a borrower under a market rate loan may pay points up front. The total amount of basis points over the benchmark in the all-in interest costs of the loan, excluding commitment fee, may not exceed 550 bps.
(2) The TIIE (*Tasa de Interés Interbancaria de Equilibrio*) rate is the representative rate for credit among banks in Mexico, and is calculated and published daily by the Bank of Mexico.
(3) Prior to June 2009, the Bank only offered base rates based on the yield on U.S. treasury securities.
(4) Prior to 2008, the minimum administrative margin applicable to market rate loans was 100 bps, regardless of the size of the loan.
(5) From 2006 to 2008, the applicable range of risk exposure spread was 0-75 bps. In 2008, the Bank increased its risk exposure spread to 0–150 bps and increased it again in 2009 to its current level (0–400 bps).
(6) The amount of risk exposure spread varies depending on creditworthiness of the borrower (or guarantor, if applicable) for direct recourse loans, or of the project, for limited recourse financing.

*Project, Evaluation, Certification, Approval and Implementation*

Potential borrowers are required to submit extensive project information to the BECC and NADB that includes, among other items, engineering reports and analyses, feasibility studies, draft agreements for key elements of the project, borrower financial statements for the previous three to five years, where applicable, project implementation and disbursement schedules, and anticipated project costs and assumptions on financial projections. With this information, BECC and NADB collectively undertake an in-depth risk assessment and project evaluation, forecast project cash flows, carry out sensitivity and stress-test scenarios, perform legal review of documentation, design collateral structure and loan payment mechanisms, as well as evaluate key project risks, including construction, operating, technology, management, input or supply, market, foreign exchange, interest rate, technical feasibility and regulatory risks. The Bank may only extend loan financing if it is satisfied, on the basis of this review, that the project is technically, environmentally, financially and economically sound, and that the project sponsors have the institutional, managerial and operating capacity to carry out the project.

All project financing and certification requires the affirmative vote of a majority of the Board of Directors appointed by each member country and must include the affirmative vote of the respective representatives of the U.S. Department of Treasury (the **Treasury**), the Mexican Department of Finance and Public Credit (**SHCP**), the EPA and the Mexican Ministry of the Environment and Natural Resources.

Although project development and implementation—from design through the bidding processes and construction—is the responsibility of the project sponsors, NADB has a strong interest in ensuring that the proceeds of its loans and grants are used efficiently and for the purposes designated in the scope of the certified project. To that end, the Bank provides substantial project oversight and support during the procurement and construction phases of project implementation.

*Non-Performing Loans and Loss Allowances*

The Bank monitors the credit quality of its borrowers on an ongoing basis and may suspend the disbursement of a loan in the event a weakness is identified that jeopardizes repayment in compliance with the contractual terms. The Bank classifies loans as non-performing when payments of principal or interest on the loan are delinquent for 90 days or more, or where reasonable doubt exists as to the borrower's ability to make timely payment. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 180 days or more, or where reasonable doubt exists as to timely collection.

To guard against the risk of delinquent and non-performing loans, the Bank allocates an allowance for expected loan losses on its financial statements. The Bank believes that its aggregate allowance for loan losses of $25.05 million is appropriate to cover all known losses at December 31, 2016. As of December 31, 2016, the Bank did not have any non-performing loans.

In the event that the full repayment of a loan is deemed doubtful, the Bank allocates a specific allowance for probable and estimable loan losses on its financial statements. The Bank evaluates credit recovery actions on a case-by-case basis and negotiates with delinquent borrowers to recover amounts due. In certain cases where a borrower experiences financial difficulties, the Bank may seek to restructure the contractual terms of the loan. Additionally, in 2013, a general allowance for loans to private-sector borrowers was established based on statistical cumulative default and recovery rates for project finance loans. The Bank also designates certain funds from its retained earnings as reserves, which are available to cover its operating and other expenses and to offset any unexpected loan losses. See "Funding Resources—General and Special Reserves." As of December 31, 2016, reserve coverage of $25.05 million in allowance for loan losses and $30.00 million in special reserve totals $55.05 million.

*Use of Derivatives*

The Bank's policies require full hedging for loans subject to currency risk. The Bank uses derivatives for the sole purpose of hedging and does not engage in any use of derivatives for speculative purposes. For loans denominated in Mexican pesos, the Bank enters into cross-currency interest rate swaps (**swaps**), which virtually eliminate exposure to fluctuations in foreign currency exchange rates and interest rates. Beginning in October 1996, the Bank benefitted from access to the swap products offered by the Fondo de Apoyo a Estados y Municipios (**FOAEM**), a fund owned by the government of Mexico and administered by the federally-run development bank, Banco Nacional de Obras y Servicios Publicos, S.N.C (**Banobras**). In July 2009, the Bank entered into a direct relationship with Banobras to serve as the swap counterparty, outside the FOAEM arrangement. The obligations of Banobras are fully backed by the Mexican federal government. In addition, since 2010, the Bank has added six commercial financial institutions as swap counterparties to foster competition on interest rate and cross-currency swap quotes.

## Guarantees

Under its Charter, as part of its development financing, the Bank may guarantee loans made by third parties to a project in whole or in part, and may also guarantee securities issued in connection with a project. The Bank currently does not have an active guarantee program, has no outstanding guarantees and does not currently anticipate instituting a guarantee program in the near future. If NADB were to develop an active guarantee program as part of its financing efforts in the future, the Charter permits it to charge a guarantee fee based on the amount of the loan outstanding and attach other conditions to the making of guarantees as it deems appropriate.

## Grants

In addition to its loan program, the Bank administers the BEIF, a grant program that is fully funded by the EPA, for the implementation of selected drinking water supply and wastewater infrastructure projects in the U.S. and Mexico. To be eligible to receive BEIF funds, projects in Mexico must have a transboundary impact. This program has been awarded funds annually by appropriation from the U.S. Congress. During 2016, seven BEIF grants totaling $21.23 million were signed. While the BEIF program was historically the core of the Bank's activities, BEIF grants have significantly decreased over the past five years, by 56.61%, comparing the average BEIF award from 2001–2011 of $37.51 million versus the average BEIF award from 2012–2016 of $16.28 million, due to decreased appropriations from the U.S. Congress to fund EPA programs.

In February 2011, the Board of Directors approved the Community Assistance Program (**CAP**) grant program to support public projects in all sectors eligible for Bank financing. The CAP program is funded from the Bank's undesignated retained earnings as authorized by the Board. As of December 31, 2016 a cumulative total of $11.47 million has been allocated to the CAP. For the years ended December 31, 2016 and 2015, $0.43 million and $1.44 million, respectively, were disbursed under this program. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

As of December 31, 2016, the Bank has contracted a total of $2.76 billion in infrastructure development financing since its inception, of which $738.32 million (26.81%) was contracted in the form of grants. Until fiscal year 2007, disbursed grants represented the majority of the Bank's financing, as compared to its outstanding loan portfolio. Over the years, the Bank has shifted its focus to loan financing as grants as a percentage of total disbursed funds have steadily decreased since 2001. Total grant disbursements were $35.70 million and $11.20 million for the years ended December 31, 2001 and 2016, respectively. While grants represented 94.51% of all disbursements for the year ended December 31, 2001, disbursed grants represented only 7.59% of the Bank's total disbursements for the year ended December 31, 2016.

## Investments

The Bank's primary investment objective is the maintenance of sufficient liquidity. Investments for the Bank's portfolio are undertaken in a manner that seeks to ensure the preservation of capital. Total return, while an important consideration, is of lesser importance than liquidity and safety of principal. As of December 31, 2016, the Bank had a liquid asset portfolio (excluding USCAIP's liquid assets) of $457.78 million. See "Financial Risk and Liquidity Management—Liquidity Policies and Liquidity Risk Management" and "Financial Risk and Liquidity Management—Investment Policy" for further information about the Bank's liquidity policy, liquid asset portfolio and investment policy.

## Technical Assistance Program

The Bank uses a limited portion of its retained earnings to provide technical assistance and training to project sponsors to support the development of environmental infrastructure projects. During fiscal year 2016, $0.33 million in grant funding was disbursed under the Technical Assistance Program (**TAP**).

## The Domestic Programs

*General*

When NADB was established in 1994, the U.S. and the Mexican governments agreed that 10% of NADB's capital would be set aside to fund community adjustment and investment programs in the U.S. and Mexico. Unlike the Bank's environmental infrastructure financing activities, the projects funded under these domestic programs are not limited to communities located within the border region and do not require BECC certification.

In addition to the financing limits established by the Bank's Charter and described under "Lending Policies—Lending Limits" above, limits to the Bank's funding of domestic programs apply. NADB's Charter provides that the total amount of loans, guarantees and grants may not exceed ten percent (10%) of the sum of the paid-in capital paid by the member country, plus the amount of such member country's unqualified subscription for callable shares.

*U.S. Domestic Program*

NADB assists the United States in administering the U.S. domestic program, USCAIP. USCAIP is designed to assist communities and the private sector in creating new jobs and preserving existing jobs in areas adjusting to changes in their economies as a result of NAFTA. USCAIP operates under the direction of a Finance Committee comprised of representatives of the U.S. Departments of the Treasury, Agriculture and Housing and Urban Development, and the U.S. Small Business Administration, along with other agencies selected by the Department of the Treasury, which serves as Finance Committee chair. Since its inception, $8.31 million in loans and $20.03 million in grants has been disbursed by the Bank for USCAIP.

NADB holds and administers funds for the USCAIP. Accordingly, USCAIP accounts are reported with and included in the accounts for the Bank's financing activities and in NADB's consolidated financial statements. However, the Bank is not involved in decisions regarding the use of USCAIP funds. As of December 31, 2016, USCAIP had available $0.79 million in equity (consisting of $2.46 million of allocated paid-in capital, $(1.68) million in designated retained earnings and $0.01 million for its special reserve) and $0.51 million in cash and cash equivalents. USCAIP is funded entirely from these allocated sources (and any net income earned by the program). Profits, losses, expenses, disbursements and other activities relating to USCAIP are funded through USCAIP's designated retained earnings and do not affect the Bank's retained earnings or paid-in capital nor would any USCAIP net income be available to support the Bank's obligations, including those under any of the Bank's debt securities or other borrowings.

More detailed information with respect to USCAIP's financial information may be found in the financial statements appended hereto.

*Mexican Domestic Program*

In June 1996, the Mexican federal government, through the SHCP, entered into a mandate agreement with the Mexican federal development bank, Banobras, to operate the Mexican domestic program and administer its funds. Accordingly, the Bank disbursed $22.50 million to Banobras, representing all of Mexico's paid-in capital for its domestic program. The Bank is not directly involved in, nor does it track or report on, the Mexican domestic program.

## Properties

The Bank's office is located at 203 South St. Mary's, Suite 300, San Antonio, Texas and is leased from the City of San Antonio under an operating lease that expires on February 28, 2026. Rent expense totaled $0.10 million for the year ended December 31, 2016.

## Funding Resources

### Capital Resources

NADB' initial authorized capital was US$3 billion, with equal commitments from the United States and Mexico. Each country authorized the subscription of 150,000 shares of the Bank's capital stock with a par value of US$10,000 per share: US$225 million in paid-in capital and US$1.275 billion in callable capital.

During 2016, the U.S. and Mexican Governments each subscribed an additional 150,000 shares of capital stock with a par value of US$10,000 per share, subject to the necessary legislation and availability of appropriations. The additional capital is classified as 45,000 paid-in shares or US$450 million and 255,000 callable shares or US$2.55 billion. The subscriptions of members to paid-in capital and callable capital stock shall be in several installments, effective on or before December 31, 2016 through December 31, 2022, or such later dates as the Board of Directors shall determine.

During 2016, Mexico made its first contribution of the additional paid-in capital of US$10 million or 1,000 shares of paid-in capital, along with the associated callable capital of US$56.67 million or 5,666.67 shares.

As of December 31, 2016, NADB had $415 million in paid-in capital, along with $2.61 billion in callable capital (with $1.275 billion corresponding to the United States and $1.331 billion to Mexico).

The callable capital must be provided by the two governments if and when required to meet the Bank's outstanding debt and guaranty obligations. Callable capital may not be used to make loans or acquire investments. Any capital call must be made uniformly to both member countries, but the obligations of the United States and Mexico, respectively, to make payment of the callable portion of their subscriptions for capital shares of to the Bank are independent of each other. As a result, the failure of one member country to make payment on any such call would not excuse the other member from its obligation to make payment and, if necessary, to meet the Bank's obligations. The Bank may make successive calls on the non-defaulting member, up to its subscribed callable capital limit. Neither member country may be required to pay more than the unpaid balance of its capital subscription. The subscription of US$1.275 billion of callable capital stock has been authorized by the U.S. Congress, but not yet appropriated. Appropriation by the U.S. Congress would be required to enable the Secretary of the U.S. Treasury to pay any portion of this amount. Similarly, the Mexican subscription of US$1.331 billion of callable capital stock has been fully authorized by its legislature, but payment upon a call would be subject to an allocation of Mexican budgetary resources for such purposes.

If the Board of Directors deems it necessary to make a capital call, the Board must pass a resolution authorizing the capital call on the U.S. and Mexican governments. In such event, it is expected that the call would be sent to the U.S. Treasury and the Mexican Department of Finance and Public Credit, the Secretaries of which are members of the Bank's Board of Directors. The Charter does not prescribe time frames by which the U.S. or Mexican governments must honor a request for callable capital.

As set forth in its Charter, ninety percent (90%) of NADB's initial authorized capital is used to finance environmental infrastructure projects in the border region, and ten percent (10%) of the capital subscribed by each country was set aside to finance the member countries' domestic programs. As a result, $405.00 million in paid-in capital (and $2.295 billion in the associated callable capital) is available to support the Bank's financing activities and the remaining $45.00 million of the Bank's paid-in capital (and $255.00 million in associated callable capital) was allocated to the domestic programs at the Bank's inception.

## General Reserve

The Bank also maintains a general reserve to cover interest and operating expenses, offset any unexpected losses on loans or guarantees and to pay expenses relating to the enforcement of the Bank's rights under outstanding loans and guarantee agreements. This reserve is distinct from the Bank's allowance for expected loan losses. As of December 31, 2016, the latter totaled $25.08 million. Of this amount, $0.03 million is allocated to USCAIP and the remaining $25.05 million is available to offset losses on loans made by the Bank. See "Business Operations—Lending Policies—Non-Performing Loans and Loss Allowance."

The general reserve consists of allocated paid-in capital and retained earnings, and is funded by an amount equal to the Bank's net income plus transfers from paid-in capital for the U.S. domestic program. As of December 31, 2016, the general reserve balance was $173.85 million, with approximately $2.46 million representing the allocated paid-in capital and retained earnings of USCAIP, with the remaining balances relating primarily to the Bank's lending activities.

The USCAIP portions of the general reserve are not available to cover NADB's operating expenses, offset losses or pay expenses relating to the Bank's financing activities. In addition, expenses and losses relating to USCAIP are limited to its general reserve amount; if that reserve is depleted, the remainder of the Bank's reserves would not be available to satisfy USCAIP's obligations.

The Bank's retained earnings consist of designated retained earnings, reserved retained earnings and undesignated retained earnings. Prior to December 2011, the Bank maintained a special reserve as part of the Bank's reserved retained earnings.

As of December 31, 2016, the special reserve balance was $30.01 million with $30.00 million relating to the Bank's lending activities. Special reserves allocated to USCAIP were $0.01 million as of December 31, 2016.

To preserve and strengthen the Bank's financial position, in December 2011 the Board of Directors approved a retained earnings policy establishing three new reserve funds as components of the reserved retained earnings in addition to the special reserve: a debt service reserve, an operating expenses reserve and a capital preservation reserve. Under the new policy, undesignated retained earnings in excess of one percent (1%) of the total assets of NADB's international program will be allocated to fund and maintain the reserves in the following order of priority:

- debt service reserve, which will be maintained in an amount equal to 12 months of interest due on the Bank's outstanding debt at each fiscal year-end;

- operating expenses reserve, which will be maintained in an amount equal to 12 months of the operating budget expenses at each fiscal year-end;

- special reserve, which will continue to be maintained in an amount equal to the sum of: (i) 1% of undisbursed loan commitments, (ii) 3% of the outstanding balance of disbursed loans, and (iii) 3% of the outstanding balance of guaranties, less the general allowance for loan losses, with a target minimum of $30 million; and

- capital preservation reserve, which is indexed to the U.S. annual inflation rate in order to maintain the value of the paid-in capital in real terms.

The debt service and operating expense reserves are intended to help the Bank meet its debt obligations in a time of financial difficulties. In the remote event that the Bank should have a need to call on its callable capital to meet its debt obligations, the Bank believes its reserves would provide a "time cushion" of one full year for the U.S. Congress to authorize the appropriation of the U.S. callable capital and for Mexico to allocate its callable capital from the corresponding budgetary resources. The Bank's debt service reserve was $30.80 million as of December 31, 2016.

**Borrowings**

In February 2010, the Bank issued $250.00 million aggregate principal amount of its notes due 2020. In October 2012, the Bank issued $250.00 million aggregate principal amount of its notes due 2022. In December 2012, the Bank issued an additional $180.00 million aggregate principal amount of its notes due 2022 and $50.00 million aggregate principal amount of its notes due 2030. In October 2013, the Bank issued $300.00 million aggregate principal amount of its notes due 2018. In April 2015, the Bank issued CHF125 million ($128.71 million) aggregate principal amount of its notes due 2025. All of these note securities have been issued at a fixed interest rate. As of December 31, 2016, the outstanding amount of the Bank's notes payable, net of discount and fair value of hedged item, was $1,155.55 million.

In November 2012, the Bank entered into a fixed rate loan agreement with another development bank for up to $50 million to be used specifically for eligible water supply and wastewater projects in Mexico. As of December 31, 2016, the outstanding balance was $28.80 million.

The Bank has a borrowing program authorized by the Board for the 2017 fiscal year that permits it to borrow up to $910.00 million either directly or indirectly through third party banks or by issuing debt.

**Financial Risk and Liquidity Management**

As a part of its development financing services, the Bank is exposed to credit risk (loan portfolio or credit and commercial credit); market risk (interest rate, spread and exchange rate); liquidity risk (funding and liquidation); and operational risk. The Bank manages its risks in accordance with its Charter and other policies approved by its Board of Directors.

## Overall Risk Management

In general, the Bank manages the risks inherent in its lending activities by ensuring that the projects it finances meet certain economic and feasibility criteria and by requiring some form of credit support, in the majority of cases, in the form of governmental revenues or other forms of collateral. The Bank's commercial risk is limited by its liquidity and investment policies. The Bank engages in cross-currency and interest rate swaps only for hedging purposes, with eight counterparties, two of which are backed by the federal government of Mexico. The other six counterparties are commercial financial institutions, which are subject to certain collateral posting requirements under a credit support agreement with the Bank. In the future, the Bank will seek to utilize more swap counterparties to further foster competition and mitigate risk.

## Credit Risk

The Bank is subject to certain credit risk. Credit risk is the potential loss that could result from the default of borrowers (loan portfolio credit risk) or from the default of the Bank's investment, trading or swap counterparties (commercial credit or counterparty risk).

*Loan Portfolio Credit Risk*

The Bank is exposed to loan portfolio credit risk as a result of its core business of providing infrastructure loans. Loan portfolio credit risk is the risk that the Bank may not receive payment of principal and/or interest on one or more of its loans in accordance with the agreed-upon terms. This risk is the largest financial risk faced by the Bank. This credit default risk is mitigated by the Bank by applying thorough credit risk analyses, stringent due diligence, and tailor-made loan structuring.

The Bank's loan portfolio credit risk is determined by the credit quality of, and exposure to, each borrower. The Bank's attitude towards credit risk is and will remain conservative. All of the loans in the Bank's outstanding portfolio are secured by some form of credit support, including federal tax revenues pledged to an irrevocable trust or pursuant to a mandate contract, system revenues, borrower cash flows or other forms of collateral, such as first liens on the project's equity and/or assets, step-in rights, reserves against cash flow or operation and management contingencies, and debt service coverage ratios, or in very limited instances, project cash flows. Since risk aversion and a commitment to strong payment structures are core principles of the Bank, NADB expects that a significant percentage of future lending will consist of secured loans.

The Bank also employs multiple operational and procedural mechanisms to further minimize its loan portfolio credit risk. These mechanisms include extensive evaluation of potential projects and borrowers, lending limits under the Charter and the Bank's loan policies, collateral and debt service requirements and policies with respect to non-performing loans and maintenance of a loan loss allowance. Proposed financing projects are first presented to the Bank's funding committee and, if approved, sent to the Board for final consideration. The Bank's Managing Director, Deputy Managing Director, Chief Financial Officer, Director of Project Development, Director of Project Administration and Technical Services, Director of Risk Management and General Counsel serve on the Bank's funding committee. See "Business Operations—Lending Policies."

*Commercial Credit and Counterparty Risks*

Financial institutions such as NADB face commercial credit risk as a result of exposure to losses that occur as a result of the default of one of the Bank's investment, trading or swap counterparties. The main sources of the Bank's commercial credit risk are the financial instruments in which the Bank invests its liquidity. The Bank maintains cash and cash equivalents, investments, and certain other financial instruments with various major financial institutions, performs periodic evaluations of the relative credit standing of these financial institutions and limits the amount of credit exposure with any one institution. See "—Liquidity Policies and Liquidity Risk Management."

To hedge its peso-denominated loan portfolio, the Bank engages in cross-currency interest rate swaps with two entities that are backed by the federal government of Mexico and with three commercial financial institutions. The Bank's counterparties are FOAEM, a fund owned by the government of Mexico and administered by Banobras, Banobras, itself, and six commercial financial institution. The obligations of Banobras are backed by the full faith and credit of the Mexican federal government. In addition, the Bank engages in interest rate swaps related to its outstanding fixed rate debt securities, as well as its fixed interest rate loans that are not funded with equity in order to mitigate its interest rate risk exposure. See "—Market Risk—Use of Derivatives."

## Liquidity Policies and Liquidity Risk Management

Liquidity risk arises from the Bank's general funding needs and the management of its financial position. It includes the risk of being unable to fund its portfolio of assets in a timely manner at appropriate maturities and rates, the risk of being unable to liquidate a position at a reasonable price when necessary, and the intensification of these two risks by having significant portions of a portfolio of assets or liabilities allocated to a specific type of instrument. NADB maintains liquidity in order to: (i) be prepared to meet its financial obligations at all times, including under conditions leading to a lack of or limited market access or market access at unusually high rates; (ii) provide confidence for credit ratings agencies, the Bank's creditors, and the Bank's shareholders that the Bank has the capacity to meet its obligations during periods of constrained market access; and (iii) ensure sufficient cash flows to cover the Bank's operational requirements in the normal course of business.

The Bank has adopted the following liquidity policy: the minimum amount of aggregate liquid asset holdings shall equal the highest consecutive 12-months of expected debt service obligations during the following 18 months, plus committed net loan disbursements (if positive), plus projected operating expenses for the relevant fiscal year. Such minimum amount of aggregate liquid asset holdings is determined prior to the beginning of each fiscal year and may be revised during the year in the event of major changes in outlook. The minimum liquidity balance for the 2017 fiscal year is $151.30 million.

The Bank may decide to hold liquidity above its minimum level to take advantage of favorable borrowing opportunities and to try to maintain a regular presence in the capital markets. Although this discretionary liquidity policy increases the level of liquidity beyond the minimum set forth in the previous paragraph, it is intended to minimize the aggregate cost of borrowing by providing a cushion of low-cost funding, which in turn would allow the Bank to pass on lower borrowing costs to its clients and generate growth in retained earnings. The Bank has established a cap on liquidity: its liquidity ordinarily shall not exceed 2.5 times the minimum liquidity balance established pursuant to its stated policy.

The Bank's investments can be classified into three categories: held-to-maturity, available-for-sale and trading securities. The Bank's liquid asset holdings are in the form of cash, cash equivalents (mainly, money market accounts and marketable securities with original maturities of up to 90 days) and investments in longer term marketable securities (fixed-income securities). While all liquid asset holdings may be designated as either trading or available-for-sale, as of the date hereof, all investments held in the Bank's liquidity portfolio are designated as available-for-sale. Securities designated as held-to-maturity are not considered liquid asset holdings for purposes of determining minimum liquidity.

The Bank's liquid assets totaled $457.78 million and $451.13 as of December 31, 2016 and 2015, respectively. This $6.65 million increase relating to the Bank's financing activities in the Bank's liquid asset portfolio was the net result of new loan disbursements and principal and interest payments from the existing loan portfolio.

**Liquid Assets**
(in U.S.$ Million)

| **Type of Security:** | **As of December 31, 2016** | **As of December 31, 2015** |
|---|---|---|
| Cash and cash equivalents | $ 151.21 | $ 113.65 |
| U.S. government and agency securities | 179.86 | 206.02 |
| United Mexican State securities | 11.56 | 13.64 |
| Corporate debt securities | 80.29 | 86.41 |
| Mortgaged-backed securities | – | 0.01 |
| Other fixed-income securities | 34.86 | 31.40 |
| **Total liquid assets** | **$ 457.78** | **$ 451.13** |

As of December 31, 2016 and 2015, 72.32% and 70.86%, respectively of the Bank's liquid asset portfolio was comprised of highly liquid assets (cash and cash equivalents and U.S. Treasuries and Agencies). The remaining 27.68% and 29.14%, respectively, were comprised of liquid assets (all other types of liquid investment securities held by the Bank) as of December 31, 2016 and 2015, respectively.

## Investment Policy

The Bank's primary investment objective is the maintenance of sufficient liquidity to (i) meet all operating expenses of the Bank; (ii) fund loan demands of the Bank; (iii) meet payments of debt service on all outstanding obligations of the Bank; and (iv) ensure proper liquidity ratios required to maintain the Bank's credit rating, as published by an SRO.

The Bank only invests in securities which have readily identifiable prices. Permissible securities that otherwise meet the Bank's investment policy comprise a wide range of high quality fixed-income instruments with the goal of seeking the preservation of capital, including U.S. Treasury and governmental agency securities, Mexican government securities, bank deposits, repurchase agreements (pursuant to master purchase agreements and fully collateralized by U.S. treasury securities), certificates of deposit, commercial paper and money market funds. The Bank's investment portfolio must contain a minimum of 25% U.S. government securities. All other securities, with the exception of corporate debt securities and Mexican government securities, must be rated AA (or its equivalent) or higher by an SRO. Repurchase agreements, certificates of deposit and commercial paper counterparties must have a short-term debt rating of A-1 (or its equivalent) or higher by an SRO.

In July 2012, the Board revised its investment policy to include corporate debt securities rated A or higher as eligible securities for a limited percentage (25% maximum) of its investment portfolio, to increase its diversification of investments by sector with a minimal amount of increased credit risk and to increase interest yield on the investment portfolio. The Bank may invest in corporate bonds and notes, so long as such securities are (i) denominated in U.S. dollars, (ii) issued by corporations rated A (or its equivalent) or higher by an SRO, and (iii) do not represent more than ten percent (10%) of the issuing entity's total debt obligations. The Bank may invest in asset-backed securities, so long as such securities are (i) issued by domestic corporations rated AAA (or its equivalent) by an SRO, and (ii) do not represent more than ten percent (10%) of the issuing entity's total debt obligations. The Bank's policy provides that investment in the following derivative securities should be avoided at all times: inverse floaters, leveraged floaters, range floaters, dual index floaters, index amortization bonds, step-up callable bonds, and other structured notes with complex coupon formulas and/or coupons that are tied to long-term or lagging interest rate indexes.

The Bank is restricted from investing more than five percent (5%) of its investment portfolio in the securities of any one issuer, excluding obligations of the U.S. Government, the Mexican Government and U.S. Government Agencies.

## Market Risk

The Bank is exposed to market risks as a result of general market movements, primarily through changes in interest and exchange rates. These risks are mitigated through the Bank's asset and liability management program, and its hedging activities.

*Interest Rate Risk*

The Bank is subject to interest rate risk as a result of its loan financing activities. The Bank is also subject to risk from interest rate movements that affect the rate it earns on its investment portfolio, which is another key component of NADB's interest income.

The Bank has minimized its exposure to a principal source of interest rate risk—the risk associated with the spread between the rate a development bank earns on its assets and the costs of its external borrowings. The Bank has been able to minimize such risk by swapping a large portion of its fixed interest rate borrowings into a floating interest rate. The remainder of the Bank's fixed interest rate borrowings was invested in a fixed rate, held-to-maturity security with a maturity matching the debt. When fixed rate loans are made with the proceeds of the swapped debt, fixed rate loans are in turn swapped to a floating rate. As a result, floating rate loans are financed with floating rate debt. The Bank is also exposed to interest rate risk to a certain extent as a function of the level of its current and future outstanding borrowings and the terms of those borrowings in relation to the terms of the assets funded by those borrowings.

The principal means of controlling the interest rate risk of the Bank's total investment portfolio is to control the average duration of the portfolio. To ensure the maintenance of adequate liquidity and to protect the Bank's portfolio from significant losses caused by interest rate movements, the average duration of the Bank's total investment portfolio may not exceed four years. The Bank structures its investment portfolio so that its investment securities mature concurrent with anticipated cash needs and anticipated demands, with further consideration for unanticipated cash demands.

*Exchange Rate Risk*

The Bank is exposed to exchange rate risk as a result of its dual-currency lending operations. To minimize exchange rate risk, NADB matches its lending operations to the local currency of the borrower. For U.S. borrowers, loans are available in U.S. dollars. For Mexican borrowers, loans may be available in Mexican pesos or in U.S. dollars if the project generates a U.S. dollar cash flow. If financing is extended in pesos, the Bank's policies require it to establish a currency hedge unless the source of funding for the loan is also in pesos. For U.S. dollar loans to Mexican borrowers, the Bank must obtain assurance that the borrower will be able to generate the dollars to make payment when due before making the loan.

COFIDAN is virtually wholly-owned by the Bank, and it is consolidated into the Bank for financial reporting purposes. Accordingly, the Bank is exposed to some exchange rate risk in the translation of COFIDAN's assets and liabilities into U.S. dollars using the exchange rate in effect at the end of the relevant financial reporting period (revenues and costs are translated using average exchange rates for the period). The resulting cumulative translation adjustment is included in the Bank's accumulated other comprehensive income, typically as a loss. Because of the small asset size, such adjustments have not been material and are not expected to be in the future.

*Use of Derivatives*

The Bank uses derivatives for the sole purpose of hedging and does not engage in any use of derivatives for speculative purposes. The Bank's lending activities include making loans that are denominated in Mexican pesos. The Bank's policies require it to establish a currency hedge for peso-denominated loans unless the source of funding for the loan is also in pesos. For such loans, the Bank enters into cross-currency interest rate swaps which virtually eliminate its economic exposure to fluctuations in foreign currency exchange rates and interest rates. As of the date hereof, the Bank has eight swap providers.

The foreign currency translation adjustment on loans denominated in Mexican pesos for the year ended December 31, 2016 equaled an unrealized loss of $55.03 million at fiscal year end, which was fully offset by the Bank's cross-currency interest rate swaps accounted for as cash flow hedges.

In connection with its borrowings, the Bank is authorized to use all necessary cross-currency and/or interest rate swaps as a liability management tool. In connection with its outstanding fixed rate debt securities, the Bank utilizes interest rate swaps to mitigate its interest rate risk exposure.

## Operational Risk

Operational risk is the potential loss arising from internal activities or external events, caused by breakdown in information, communication, physical safeguards, business continuity, supervision, transactions processing, pricing and cash and securities movements and settlement systems. In addition, operational risk includes fraud and failures in the execution of legal, fiduciary and agency responsibilities. These risks stem from the manner in which the Bank is operated, as opposed to the way it is financed.

NADB manages its operational risk through a system of internal controls based on established policies and procedures for all significant areas of operation, including funds management, disbursements, procurement and financial reporting. This system is strengthened by the Bank's highly qualified personnel who maintain the highest standards of integrity and professionalism in the performance of their duties. In addition, in 2014, the Bank established the Risk Management and Control Department (RMC) to centralize the risk management function and continually asscess and reinforce all aspects of its risk management strategies and tools.

The Bank also maintains insurance to protect against operational risk, including commercial insurance, business automobile insurance, travelers' insurance and occupational accident insurance policies.

## Administration and Governance

## Board of Directors (the Board)

NADB and the BECC are governed by a common, ten-member Board comprised of three cabinet-level federal government representatives from each country, a representative of a border state from each country, and a representative of the general public who resides in the border region from each country.

The federal government representative on the Board include the U.S. Secretary of the Treasury, Secretary of State and Administrator of the EPA and the Mexican Secretary of Finance and Public Credit, Secretary of Foreign Relations and Secretary of the Environment and Natural Resources. The local representatives on the Board consist of a state representative from a border state in the United States of America, the head of state coordination unit of the Ministry of Finance and Public Credit, and a representative of the general public, one from the U.S. and one from Mexico, who reside in the border region. The local representatives are appointed by the relevant member country, at its discretion. Chairmanship of the Board alternates between the U.S. and Mexican treasury representatives each year.

Under its Charter, all Board decisions require the approval of a majority of the directors appointed by each member country. With respect to project certifications, the Board may vote for certification only after the public has had an opportunity to comment, during a public comment period of no less than 30 days. In addition, decisions relating to or affecting project certification or financing require the affirmative vote of the U.S. Secretary of the Treasury and Administrator of the EPA and the Mexican Secretary of Finance and Public Credit and Secretary of the Environment and Natural Resources

## Officers

Under the direction of the Board, the business of NADB is conducted by the Managing Director and Deputy Managing Director, who oversee development of NADB's current and long-range objective, policies and procedures. The Managing Director and Deputy Managing Director generally serve nonrenewable terms of 5 years. The offices of Managing director and Deputy Managing Director alternate between nationals of the two member countries and must be occupied by nationals of different member countries at all times.

Mr. Alex Hinojosa, a U.S. citizen, was appointed Deputy Managing Director of NADB in January 2011 and as of April 13, 2017, was named Acting Managing Director. On that same date, Dr. Calixto Mateos, a Mexican citizen and Director of Risk Management and Control, was named Acting Deputy Managing Director. They are assisted by compact staff of 63 employees who carry out the day-to-day operations of NADB.

NADB's management team also includes Chief Financial Officer, Héctor M. Camacho; Interim Director of Administration, Eduardo Macias; Director of Project Development, Carlos Carranza; Director of Project Administration and Technical Services, Rafael Escandón; Director of Public Affairs, Jesse J. Hereford; and General Counsel, Lisa Roberts.

The address of NADB's management is 203 South St. Mary's, Suite 300, San Antonio, Texas 78205, USA.

## Dividends

The Board of Directors may determine periodically what part of the net profits and of the surplus of the capital resources shall be distributed. Such distributions may be made only when the reserves have reached a level which the Board of Directors considers adequate. The Board of Directors has never distributed any dividends.

## Financial Reports

For information on financial reports, please refer to the Annex to this Prospectus.

# Audited Consolidated Financial Statements for the years ended December 31, 2016 and 2015

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# Consolidated Financial Statements and Supplementary Information

North American Development Bank
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

North American Development Bank

Consolidated Financial Statements and Supplementary Information

Years Ended December 31, 2016 and 2015

## Contents

Building a better
working world

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# Report of Independent Auditors

The Board of Directors
North American Development Bank:

We have audited the accompanying consolidated financial statements of North American Development Bank (the Bank), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of North American Development Bank at December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Combining Balance Sheet by Program, Combining Statement of Income by Program, Combining Statement of Comprehensive Income by Program, Combining Statement of Cash Flows by Program, and the Border Environment Infrastructure Fund are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst & Young LLP

March 31, 2017

## North American Development Bank

## Consolidated Balance Sheets

| | December 31 2016 | 2015 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents: | | |
| Held at other financial institutions in demand-deposit accounts | **$ 193,964** | $ 127,078 |
| Held at other financial institutions in interest-bearing accounts | **28,833,505** | 31,052,800 |
| Repurchase agreements | **122,700,000** | 83,800,000 |
| | **151,727,469** | 114,979,878 |
| Held-to-maturity investment securities, at amortized cost | **53,782,155** | 53,730,753 |
| Available-for-sale investment securities, at fair value | **306,562,226** | 337,477,241 |
| Loans outstanding | **1,411,625,673** | 1,325,135,449 |
| Allowance for loan losses | **(25,075,659)** | (19,941,922) |
| Unamortized loan fees | **(10,682,210)** | (9,661,632) |
| Foreign currency exchange rate adjustment | **(55,027,169)** | (43,446,961) |
| Hedged items, at fair value | **(151,854,451)** | (51,606,468) |
| Net loans outstanding | **1,168,986,184** | 1,200,478,466 |
| Interest receivable | **26,806,845** | 11,226,560 |
| Grant and other receivable | **7,320,234** | 699,125 |
| Furniture, equipment and leasehold improvements, net | **461,759** | 257,012 |
| Other assets | **98,029,324** | 59,103,755 |
| Total assets | **$ 1,813,676,196** | $ 1,777,952,790 |
| **Liabilities and equity** | | |
| Liabilities: | | |
| Accounts payable | **$ 7,456,087** | $ 1,813,084 |
| Accrued liabilities | **441,447** | 350,020 |
| Accrued interest payable | **16,593,968** | 9,079,465 |
| Undisbursed grant funds | **6,328** | 1,000 |
| Other liabilities | **–** | 6,210,968 |
| Short-term debt | **5,262,000** | 5,262,000 |
| Long-term debt, net of discount and unamortized debt issuance costs | **1,176,158,912** | 1,177,851,550 |
| Hedged items, at fair value | **2,931,548** | 10,180,086 |
| Net long-term debt | **1,179,090,460** | 1,188,031,636 |
| Total liabilities | **1,208,850,290** | 1,210,748,173 |
| Equity: | | |
| Paid-in capital | **415,000,000** | 405,000,000 |
| General Reserve: | | |
| Allocated paid-in capital | **2,460,790** | 3,027,256 |
| Retained earnings: | | |
| Designated | **11,780,134** | 12,920,792 |
| Reserved | **114,553,374** | 99,671,114 |
| Undesignated | **45,058,709** | 39,394,125 |
| Accumulated other comprehensive income | **15,967,278** | 7,185,567 |
| Non-controlling interest | **5,621** | 5,763 |
| Total equity | **604,825,906** | 567,204,617 |
| Total liabilities and equity | **$ 1,813,676,196** | $ 1,777,952,790 |

*The accompanying notes are an integral part of these consolidated financial statements.*

# North American Development Bank

## Consolidated Statements of Income

| | Year Ended December 31 | |
|---|---|---|
| | **2016** | 2015 |
| Interest income: | | |
| Loans | **$ 52,430,015** | $ 45,910,933 |
| Investments | **6,586,686** | 5,355,434 |
| Total interest income | **59,016,701** | 51,266,367 |
| | | |
| Interest expense | **19,950,461** | 15,101,220 |
| Net interest income | **39,066,240** | 36,165,147 |
| | | |
| Operating expenses: | | |
| Personnel | **8,282,656** | 5,590,704 |
| General and administrative | **1,467,292** | 1,712,742 |
| Consultants and contractors | **2,720,662** | 2,205,079 |
| Provision for loan losses | **5,133,737** | 8,559,254 |
| Other | **193,253** | 214,167 |
| Depreciation | **137,153** | 76,409 |
| U.S. Domestic Program | **268,461** | 285,955 |
| Total operating expenses | **18,203,214** | 18,644,310 |
| | | |
| Net operating income | **20,863,026** | 17,520,837 |
| | | |
| Non-interest income and expenses: | | |
| Gains on sales of available-for-sale securities | **137,177** | 39,995 |
| Income (expense) from hedging activities, net | **1,101,921** | 3,584,628 |
| Income (expense) from foreign exchange activities, net | **(701,842)** | (501,788) |
| Fees and other income | **200,000** | 429,078 |
| Loss on other real estate owned | **(1,106,240)** | (950,000) |
| Total non-interest income (expense) | **(368,984)** | 2,601,913 |
| | | |
| Income before program activities | **20,494,042** | 20,122,750 |
| | | |
| Program activities: | | |
| U.S. Environmental Protection Agency (EPA) grant income | **843,300** | 832,143 |
| EPA grant administration expense | **(843,300)** | (832,143) |
| Technical Assistance Program expense | **(537,557)** | (1,179,090) |
| Community Assistance Program expense | **(429,633)** | (1,436,053) |
| Water Conservation Investment Fund expense | **(120,808)** | (2,257,725) |
| Net program expenses | **(1,087,998)** | (4,872,868) |
| | | |
| Income before non-controlling interest | **19,406,044** | 15,249,882 |
| Net loss attributable to non-controlling interest | **(142)** | (242) |
| Net income attributable to NADB | **$ 19,406,186** | $ 15,250,124 |

*The accompanying notes are an integral part of these consolidated financial statements.*

# North American Development Bank

## Consolidated Statements of Comprehensive Income

| | Year Ended December 31 | |
|---|---|---|
| | **2016** | **2015** |
| Income before non-controlling interest | **$ 19,406,044** | $ 15,249,882 |
| Net loss attributable to non-controlling interest | **(142)** | (242) |
| Net income attributable to NADB | **19,406,186** | 15,250,124 |
| Other comprehensive income (loss): | | |
| Available-for-sale investment securities: | | |
| Change in unrealized gains (losses) during the period, net | **15,481** | (344,579) |
| Reclassification adjustment for net gains included in net income | **(137,177)** | (39,995) |
| Total unrealized loss on available-for-sale investment securities | **(121,696)** | (384,574) |
| Foreign currency translation adjustment | **158,889** | 147,893 |
| Unrealized gains (losses) on hedging activities: | | |
| Foreign currency translation adjustment, net | **(11,580,208)** | (11,501,378) |
| Fair value of cross-currency interest rate swaps, net | **20,324,726** | 19,117,644 |
| Total unrealized gain on hedging activities | **8,744,518** | 7,616,266 |
| Total other comprehensive income | **8,781,711** | 7,379,585 |
| Total comprehensive income | **$ 28,187,897** | $ 22,629,709 |

*The accompanying notes are an integral part of these consolidated financial statements.*

# North American Development Bank

## Consolidated Statement of Changes in Equity

| | Paid-In Capital | General Reserve: Allocated Paid-In Capital | General Reserve: Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Non-controlling Interest | Total Equity |
|---|---|---|---|---|---|---|
| Beginning balance, January 1, 2015 | $ 405,000,000 | $ 4,337,076 | $ 136,735,907 | $ (194,018) | $ 6,005 | $ 545,884,970 |
| Transfer to Targeted Grant Program of the U.S. Domestic Program | – | (1,309,820) | – | – | – | (1,309,820) |
| Net income | – | – | 15,250,124 | – | – | 15,250,124 |
| Other comprehensive loss | – | – | – | 7,379,585 | – | 7,379,585 |
| Non-controlling interest | – | – | – | – | (242) | (242) |
| Ending balance, December 31, 2015 | 405,000,000 | 3,027,256 | 151,986,031 | 7,185,567 | 5,763 | 567,204,617 |
| Capital contribution | **10,000,000** | **–** | **–** | **–** | **–** | **10,000,000** |
| Transfer to Targeted Grant Program of the U.S. Domestic Program | **–** | **(566,466)** | **–** | **–** | **–** | **(566,466)** |
| Net income | **–** | **–** | **19,406,186** | **–** | **–** | **19,406,186** |
| Other comprehensive income | **–** | **–** | **–** | **8,781,711** | **–** | **8,781,711** |
| Non-controlling interest | **–** | **–** | **–** | **–** | **(142)** | **(142)** |
| Ending balance, December 31, 2016 | **$ 415,000,000** | **$ 2,460,790** | **$ 171,392,217** | **$ 15,967,278** | **$ 5,621** | **$ 604,825,906** |

*The accompanying notes are an integral part of these consolidated financial statements.*

# North American Development Bank

## Consolidated Statements of Cash Flows

| | Year Ended December 31 | |
|---|---|---|
| | **2016** | **2015** |
| **Operating activities** | | |
| Net income | **$ 19,406,186** | $ 15,250,124 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation | **137,153** | 76,409 |
| Amortization of net premium (discounts) on investments | **907,746** | 1,618,069 |
| Change in fair value of swaps, hedged items and other non-cash items | **68,912,405** | 43,358,596 |
| Non-controlling interest | **(142)** | (242) |
| Gain on sales of available-for-sale investment securities, net | **(137,177)** | (39,995) |
| Provision for loan losses | **5,133,737** | 8,559,254 |
| Change in other assets and liabilities: | | |
| Increase in interest receivable | **(15,580,285)** | (768,416) |
| (Increase) decrease in receivable and other assets | **(4,813,027)** | 2,081,279 |
| Increase in accounts payable | **5,643,003** | 746,878 |
| Increase in accrued liabilities | **91,427** | 57,795 |
| Increase in accrued interest payable | **7,514,503** | 684,724 |
| Net cash provided by operating activities | **87,215,529** | 71,624,475 |
| **Lending, investing, and development activities** | | |
| Capital expenditures | **(342,452)** | (156,100) |
| Loan principal repayments | **49,762,528** | 110,630,097 |
| Loan disbursements | **(136,252,752)** | (249,555,763) |
| Purchase of held-to-maturity investments | **(2,261,000)** | (2,292,397) |
| Purchase of available-for-sale investments | **(240,224,271)** | (257,306,015) |
| Proceeds from maturities of held-to-maturity investments | **2,235,000** | 2,250,000 |
| Proceeds from sales and maturities of available-for-sale investments | **270,221,619** | 222,045,417 |
| Net cash used in lending, investing, and development activities | **(56,861,328)** | (174,384,761) |
| **Financing activities** | | |
| Capital contribution | **10,000,000** | – |
| Proceeds from other borrowings | **2,216,528** | 4,521,469 |
| Proceeds from note issuance | **–** | 129,503,444 |
| Principal repayment of other borrowings | **(5,262,000)** | (2,631,000) |
| Grant funds from the Environmental Protection Agency (EPA) | **10,650,006** | 9,633,948 |
| Grant disbursements – EPA | **(10,644,678)** | (9,633,948) |
| Grant activity – U.S. Domestic Program | **(566,466)** | (1,309,820) |
| Net cash provided by financing activities | **6,393,390** | 130,084,093 |
| Net increase in cash and cash equivalents | **36,747,591** | 27,323,807 |
| Cash and cash equivalents at January 1, 2016 and 2015 | **114,979,878** | 87,656,071 |
| Cash and cash equivalents at December 31, 2016 and 2015 | **$ 151,727,469** | $ 114,979,878 |
| **Supplemental cash information** | | |
| Cash paid during the year for interest | **$ 30,730,491** | $ 30,439,744 |
| **Significant noncash transactions** | | |
| Foreign currency translation adjustment | **$ (11,580,208)** | $ (11,501,378) |
| Change in fair value of cross-currency interest rate swaps, net | **20,324,726** | 19,117,644 |
| Change in fair value of available-for-sales investments, net | **(121,696)** | (384,574) |

*The accompanying notes are an integral part of these consolidated financial statements.*

## 1. Organization and Purpose

The North American Development Bank (NADB or the Bank) was established on January 1, 1994 by an agreement between the Governments of the United States of America (the United States or U.S.) and the United Mexican States (Mexico) that was signed by their respective Presidents on November 16 and 18, 1993 (the Charter). The Bank was created to finance environmental infrastructure projects in the U.S.-Mexico border region (the International Program) and community adjustment and investment projects throughout the U.S. and Mexico in support of the purposes of the North American Free Trade Agreement (NAFTA) (the Domestic Programs). On March 16, 1994, the President of the United States issued an Executive Order designating the Bank an international organization under the International Organization Immunities Act.

The Bank is governed by a Board of Directors appointed by the two countries. The operations of the Bank are subject to certain limitations outlined in the Charter, as amended on August 6, 2004. The geographic jurisdiction of the International Program is within 100 kilometers north of the U.S.-Mexico border and within 300 kilometers south of the border. The Bank is located in San Antonio, Texas.

Under its International Program, the Bank provides loan and grant financing and technical assistance for environmental infrastructure projects certified by the Border Environment Cooperation Commission (BECC), as appropriate, and administers grant funding provided by other entities. Under the Domestic Programs, the Bank contributed funds from its equity to establish the domestic program of each country, and continues to administer the funds of the U.S. Domestic Program (see Note 8).

On June 2, 1998, the Board of Directors adopted a resolution authorizing the Bank to establish a limited-purpose financial institution (*sociedad financiera de objeto limitado*, SOFOL) for the purpose of facilitating Bank lending to the Mexican public sector. In January 1999, the *Corporación Financiera de América del Norte, S.A. de C.V. SOFOL* (COFIDAN) began operations in Mexico City and, in October 2006, COFIDAN was converted from a SOFOL to a non-regulated, multipurpose financial institution (SOFOM, E.N.R.), and its name was modified to *Corporación Financiera de América del Norte, S.A. de C.V. SOFOM E.N.R.* As of December 31, 2016, COFIDAN is 99.90% owned by the Bank and 0.10% owned by the Government of Mexico. The accounts of COFIDAN are consolidated with the Bank, and all material intercompany accounts and transactions are eliminated in consolidation. The non-controlling interest reflected in the consolidated balance sheets and consolidated statements of income represents the ownership of the Government of Mexico through the Ministry of Finance and Public Credit (SHCP).

## 2. Summary of Significant Accounting Policies

### Basis of Presentation and Use of Estimates in Financial Statements

The financial statements have been prepared in conformity with U.S. generally accepted accounting principles and are presented in a manner consistent with that of an international organization. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates include the valuation of investments, allowance for loan losses, the fair value of derivative instruments and other real estate owned included in other assets, and the fair value of derivative instruments included in other liabilities and in long-term debt. Actual results could differ from those estimates.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Bank and its subsidiary, COFIDAN. All significant intercompany accounts and transactions have been eliminated in consolidation.

### Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash deposits with other financial institutions and overnight repurchase agreements.

### Repurchase Agreements

The Bank has entered into agreements with two major financial institutions to purchase various U.S. government and federally sponsored agency securities under an agreement to resell. The purchase and resale of these securities occur daily, and the obligation to repurchase is backed by the assets of the related financial institutions. The underlying securities related to the repurchase transaction are held in the possession of the respective financial institutions.

### Investment Securities

The Bank's investments are classified into the following categories:

> *Held-to-maturity* – This category is composed of those debt securities for which the Bank has the positive intent and ability to hold to maturity. These securities are carried at amortized cost.

**2. Summary of Significant Accounting Policies (continued)**

*Trading* – This category is composed of debt securities that are bought and held for resale in the near term. These securities are carried at fair value, and changes in market value are recognized in the consolidated statements of income.

*Available-for-sale* – This category is composed of debt securities that are not classified as either trading or held-to-maturity securities. These securities are carried at fair value, with unrealized holding gains and losses excluded from earnings and reported as a net amount in a separate component of comprehensive income or loss until realized.

The accretion of discounts and the amortization of premiums are computed using the interest method. Realized gains and losses are determined using the specific identification method. Investments in a loss position are reviewed in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. In the event of other-than-temporary impairment, the cost basis of the investment would be written down to its fair value, and the credit component of the loss would be included in current earnings. The Bank had no securities classified as other-than-temporarily impaired as of December 31, 2016 and 2015.

**Taxation**

As an international organization, the Bank is exempt from all federal, state, and local taxation to the extent implemented by law under the U.S. International Organizations Immunities Act of 1945.

**Furniture, Equipment, and Leasehold Improvements**

Furniture and equipment are recorded at cost and depreciated over their estimated useful lives using the straight-line method. The estimated useful life is three years for computers and five years for furniture and other equipment. Leasehold improvements are recorded at cost and amortized over five years, or the life of the lease, whichever is less.

**General Reserve**

The Board of Directors defines the General Reserve as retained earnings plus allocated paid-in capital for the U.S. Domestic Program, as described in Note 8. Retained earnings are classified as either designated for a specific program, reserved, or undesignated. Undesignated retained

**2. Summary of Significant Accounting Policies (continued)**

earnings in excess of one percent (1.0%) of total assets of the International Program are used to fund four reserves in the following order of priority:

> *Debt Service Reserve* – This reserve is maintained in an amount equal to 12 months of interest due on the Bank's outstanding debt at each fiscal year-end.
>
> *Operating Expenses Reserve* – This reserve is maintained in an amount equal to 12 months of the operating budget expenses at each fiscal year-end.
>
> *Special Reserve* – This reserve is maintained in an amount equal to the sum of: 1% of undisbursed loan commitments, 3% of the outstanding balance of disbursed loans and 3% of the outstanding balance of guaranties, less the general allowance for loan losses, with a targeted minimum of $30 million. Amounts in the Special Reserve are to be used to pay costs associated with the enforcement of the Bank's rights under its loan and guaranty agreements and to offset losses on any loan or guaranty.
>
> *Capital Preservation Reserve* – This reserve is intended to maintain the value of the paid-in capital in real terms and is indexed to the U.S. annual inflation rate.

**Loans and Allowance for Loan Losses**

Loans are reported at the principal amount, net of allowance for loan losses, unamortized loan fees, foreign currency exchange rate adjustment, and fair value of hedged items. Interest income on loans is recognized in the period earned. Net loan commitment and origination fees are deferred and amortized over the life of the loan as an adjustment to loan interest income.

Loans that are past due 90 days or more as to principal or interest, or where reasonable doubts exist as to timely collection, including loans that are individually identified as being impaired, are generally classified as nonperforming loans unless well secured and in the process of collection.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 180 days (unless adequately secured and in the process of collection) or circumstances indicate that the full collection of principal and interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if current-year interest) or charged against current-year interest (if prior-year interest).

**2. Summary of Significant Accounting Policies (continued)**

Payments received on nonaccrual loans are generally applied to the recorded principal in the loan asset. If collection of the recorded principal in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, payments are recognized as interest income. Nonaccrual loans may be returned to accrual status when contractual principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified as "doubtful" or "loss." If previously unrecognized interest income exists upon reinstatement of a nonaccrual loan to accrual status, interest income will only be recognized upon receipt of cash payments applied to the loan.

In cases where a borrower experiences financial difficulties and the Bank makes certain concessions to the borrower through modifications of the contractual terms of the loan, the loan is classified as a troubled debt restructuring. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan losses incurred as of the financial statement date. Determining the appropriate allowance for loan losses involves significant judgment about when a loss has been incurred and the amount of that loss. A specific allowance is established for impaired loans that exhibit a distinct possibility that the Bank may sustain some loss. Impairment of these loans is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral-dependent. In 2013, under the International Program, a general allowance for loans to private-sector borrowers was established based on statistical cumulative default and recovery rates for project finance loans. In 2016, the general allowance methodology was expanded to include public and public-private borrowers.

The allowance for loan losses is maintained at a level considered appropriate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provision for loan losses and is decreased through reversals of provision for loan losses and loan charge-offs. Upon final settlement of impaired loans, any remaining loss is charged off.

## 2. Summary of Significant Accounting Policies (continued)

### Credit Quality

The Bank monitors the credit quality of its loan portfolio on an ongoing basis by tracking certain credit quality indicators related to the borrower's: (i) payment history, (ii) strength of management, (iii) financial performance, (iv) appropriateness and effectiveness of project technology, and (v) loan covenant compliance, as well as (vi) general economic conditions in the borrower's geographic location, (vii) the legal and regulatory environment, and (viii) the effects, if any, of the current political environment. Based on this evaluation, each loan is assigned to one of the following risk categories:

*Pass* – The loan is not considered a greater than normal credit risk. The Bank believes the borrower has the ability to meet its obligations; therefore, the Bank anticipates insignificant uncollectible amounts.

*Special Mention* – The loan has exhibited potential weaknesses that deserve the Bank's close attention. If left uncorrected, these potential weaknesses may result in noticeable deterioration of the repayment prospects for the asset or of the borrower's credit position.

*Substandard* – The loan is inadequately protected by the current financial condition and paying capacity of the borrower or by any collateral pledged. The loan has a well-defined weakness or weaknesses that may jeopardize the collection of the debt pursuant to the contractual principal and interest terms. Such risk is characterized by the distinct possibility that the Bank may sustain some loss if the deficiencies are not corrected.

*Doubtful* – In addition to the risk characteristics described in the substandard category, the loan exhibits conditions and values that make collection or liquidation in full highly improbable. Loans in this risk category are closely managed to determine the highest recovery alternatives.

### Program Activities

Grant income represents reimbursed administrative expenses associated with the U.S. Environmental Protection Agency (EPA) grant activities. Such amounts are earned and recognized as grant income in the accompanying consolidated statements of income as the associated expenses are incurred.

**2. Summary of Significant Accounting Policies (continued)**

Program expenses include grant disbursements made by the Bank and administrative costs associated with EPA grant activities. Grants are recognized at the date the Bank becomes obligated under the terms of the grant agreements, and associated costs are recognized as incurred. EPA and U.S. Domestic Program grant receipts and disbursements reflected in the consolidated statements of cash flows are not reflected in the accompanying consolidated statements of income, as these grants are approved and funded by the respective entities noted above. The Bank's role is to administer these funds.

**Foreign Currency**

COFIDAN is located in Mexico and operates primarily using the local functional currency. Accordingly, all assets and liabilities of COFIDAN are translated using the exchange rate in effect at the end of the period, and revenue and costs are translated using average exchange rates for the period. The resulting cumulative translation adjustment is included in accumulated other comprehensive income.

The lending activities of the Bank include making loans that are denominated in Mexican pesos. For such loans, the Bank enters into cross-currency interest rate swaps that mitigate its exposure to fluctuations in foreign currency exchange rates and interest rates. As of December 31, 2016, the Bank had entered into swap counterparty agreements with *Fondo de Apoyo a Estados y Municipios* (FOAEM), a fund owned by the Government of Mexico and administered by the federally run development bank, *Banco Nacional de Obras y Servicios Publicos, S.N.C.* (Banobras); directly with Banobras outside the FOAEM arrangement; and with six other financial institutions. The foreign currency translation adjustment on loans denominated in Mexican pesos as of December 31, 2016 and 2015 was $(55,027,169) and $(43,446,961), respectively. Changes in the foreign currency translation adjustment are reported through other comprehensive income.

All swaps relating to the lending activities of the Bank have been designated as cash flow or fair value hedges and are recognized in the accompanying consolidated balance sheets at their fair value. Changes in the fair value of the cash flow hedges are reported in other comprehensive income and are reclassified to earnings at the time of the hedged loan repayment. Changes in the fair value of the fair value hedges are reported as non-interest income or expense.

The Bank discontinues hedge accounting prospectively if it determines that the derivative is no longer highly effective in offsetting changes in the fair value or cash flows of the hedged item, or if it is no longer probable that the hedged loan repayment will occur. If hedge accounting is

**2. Summary of Significant Accounting Policies (continued)**

discontinued because the hedge ceases to be effective, the Bank will continue to record the swap at fair value with changes in value reflected in earnings for the period, and any fair value adjustments included in other comprehensive income will be recognized in the consolidated statements of income over the remaining life of the loan. If it is probable that the hedged loan repayments will not occur, gains and losses accumulated in other comprehensive income (loss) are recognized immediately in earnings.

Derivatives executed with all swap counterparties except for FOAEM are subject to a master netting arrangement. The net fair value of derivatives by counterparty is offset with the outstanding balance of the collateral received from or paid to the counterparty for financial reporting purposes. Additional information on the amounts subject to master netting arrangements and collateral is provided in Note 5.

**Fair Value**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Bank carries cross-currency interest rate swaps, interest rate swaps, hedged items, and available-for-sale debt securities at fair value. To determine the fair market value of its financial instruments, the Bank uses the fair value hierarchy, which is based on three levels of inputs as follows:

> Level 1 – Quoted prices in active markets for identical assets or liabilities, which the reporting entity has the ability to access at the measurement date. This category generally includes U.S. government securities.
>
> Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. This category generally includes U.S. agency securities, corporate debt securities, other fixed-income securities, United Mexican States (UMS) securities, and mortgage-backed debt securities.
>
> Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant in determining the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash

## 2. Summary of Significant Accounting Policies (continued)

flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category includes cross-currency interest rate swaps, interest rate swaps, the fair value of hedged items, and other real estate owned where independent pricing information is not available for a significant portion of the underlying assets. For these consolidated financial statements, the Bank also obtains dealer quotations for comparative purposes to assess the reasonableness of the pricing models.

Additional information on the fair value of the financial instruments of the Bank is provided in Note 11.

### Accumulated Other Comprehensive Income

The components of other comprehensive income are reported in the accompanying consolidated statements of comprehensive income for all periods presented and in Note 7.

### Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified to conform to the current year consolidated financial statement presentation.

In 2016, the Bank adopted ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30) – Simplifying the Presentation of Debt Issuance Costs.* ASU 2015-03 requires that debt issuance costs related to a debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The consolidated balance sheet as of December 31, 2015 reflects a $4,285,143 decrease in other assets and a $4,285,143 decrease in long-term debt, net of discount and unamortized debt issuance costs.

## 3. Investments

All investments held by the Bank are classified as either held-to-maturity or available-for-sale securities. The following schedule summarizes investments as of December 31, 2016 and 2015.

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2016** | | | | |
| Held-to-maturity: | | | | |
| U.S. agency securities | **$ 3,868,082** | **$ 3,857** | **$ (23,507)** | **$ 3,848,432** |
| Mexican government securities (UMS) | **49,914,073** | **3,760,927** | **–** | **53,675,000** |
| Total held-to-maturity investment securities | **53,782,155** | **3,764,784** | **(23,507)** | **57,523,432** |
| | | | | |
| Available-for-sale: | | | | |
| U.S. government securities | **117,552,445** | **73,113** | **(299,703)** | **117,325,855** |
| U.S. agency securities | **62,587,782** | **176,961** | **(232,308)** | **62,532,435** |
| Corporate debt securities | **80,420,243** | **110,155** | **(240,116)** | **80,290,282** |
| Other fixed-income securities | **34,887,582** | **4,217** | **(34,100)** | **34,857,699** |
| Mexican government securities (UMS) | **11,661,736** | **4,957** | **(110,738)** | **11,555,955** |
| Mortgage-backed securities | **–** | **–** | **–** | **–** |
| Total available-for-sale investment securities | **307,109,788** | **369,403** | **(916,965)** | **306,562,226** |
| Total investment securities | **$ 360,891,943** | **$ 4,134,187** | **$ (940,472)** | **$ 364,085,658** |

### 3. Investments (continued)

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2015** | | | | |
| Held-to-maturity: | | | | |
| U.S. agency securities | $ 3,842,082 | $ 1,188 | $ (6,178) | $ 3,837,092 |
| Mexican government securities (UMS) | 49,888,671 | 4,611,329 | – | 54,500,000 |
| Total held-to-maturity investment securities | 53,730,753 | 4,612,517 | (6,178) | 58,337,092 |
| Available-for-sale: | | | | |
| U.S. government securities | 134,578,402 | 35,197 | (193,458) | 134,420,141 |
| U.S. agency securities | 71,593,623 | 109,503 | (108,783) | 71,594,343 |
| Corporate debt securities | 86,571,067 | 71,599 | (228,745) | 86,413,921 |
| Other fixed-income securities | 31,410,892 | 19,308 | (25,880) | 31,404,320 |
| Mexican government securities (UMS) | 13,741,982 | – | (104,682) | 13,637,300 |
| Mortgage-backed securities | 7,141 | 75 | – | 7,216 |
| Total available-for-sale investment securities | 337,903,107 | 235,682 | (661,548) | 337,477,241 |
| Total investment securities | $ 391,633,860 | $ 4,848,199 | $ (667,726) | $ 395,814,333 |

## 3. Investments (continued)

The following schedule summarizes unrealized losses and the fair value of investments aggregated by category and the length of time individual securities have been in a continuous unrealized loss position as of December 31, 2016 and 2015.

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| **December 31, 2016** | | | | | | |
| Held-to-maturity: | | | | | | |
| U.S. agency securities | **$ 2,767,178** | **$ 23,507** | **$ –** | **$ –** | **$ 2,767,178** | **$ 23,507** |
| Available-for-sale: | | | | | | |
| U.S. government securities | **59,557,510** | **299,703** | **–** | **–** | **59,557,510** | **299,703** |
| U.S. agency securities | **19,363,071** | **232,308** | **–** | **–** | **19,363,071** | **232,308** |
| Corporate debt securities | **42,222,042** | **240,116** | **–** | **–** | **42,222,042** | **240,116** |
| Other fixed-income securities | **19,571,379** | **34,100** | **–** | **–** | **19,571,379** | **34,100** |
| Mexican government securities (UMS) | **7,817,425** | **110,738** | **–** | **–** | **7,817,425** | **110,738** |
| Total available-for-sale investment securities | **148,531,427** | **916,965** | **–** | **–** | **148,531,427** | **916,965** |
| Total temporarily impaired securities | **$ 151,298,605** | **$ 940,472** | **$ –** | **$ –** | **$ 151,298,605** | **$ 940,472** |
| **December 31, 2015** | | | | | | |
| Held-to-maturity: | | | | | | |
| U.S. agency securities | $ 1,528,507 | $ 6,178 | $ – | $ – | $ 1,528,507 | $ 6,178 |
| Available-for-sale: | | | | | | |
| U.S. government securities | 120,167,738 | 193,457 | – | – | 120,167,738 | 193,457 |
| U.S. agency securities | 44,930,182 | 108,784 | – | – | 44,930,182 | 108,784 |
| Corporate debt securities | 56,118,940 | 228,745 | – | – | 56,118,940 | 228,745 |
| Other fixed-income securities | 24,132,655 | 25,880 | – | – | 24,132,655 | 25,880 |
| Mexican government securities (UMS) | 13,637,300 | 104,682 | – | – | 13,637,300 | 104,682 |
| Total available-for-sale investment securities | 258,986,815 | 661,548 | – | – | 258,986,815 | 661,548 |
| Total temporarily impaired securities | $ 260,515,322 | $ 667,726 | $ – | $ – | $ 260,515,322 | $ 667,726 |

**3. Investments (continued)**

None of the unrealized losses identified in the preceding table are considered to be other-than-temporary since, as of December 31, 2016, the Bank did not have the intent to sell any of these securities and believed that it was more-likely-than-not that the Bank would not be required to sell any such securities before a recovery of cost.

Contractual maturities of investments as of December 31, 2016 and 2015 are summarized in the following tables.

| | Held-to-Maturity Securities | | Available-for-Sale Securities | |
|---|---|---|---|---|
| | **Fair Value** | **Amortized Cost** | **Fair Value** | **Amortized Cost** |
| **December 31, 2016** | | | | |
| Less than 1 year | **$ 973,654** | **$ 974,685** | **$ 169,910,035** | **$ 169,947,758** |
| 1–5 years | **56,549,778** | **52,807,470** | **136,652,191** | **137,162,030** |
| 5–10 years | – | – | – | – |
| More than 10 years | – | – | – | – |
| Mortgage-backed securities | – | – | – | – |
| | **$ 57,523,432** | **$ 53,782,155** | **$ 306,562,226** | **$ 307,109,788** |
| **December 31, 2015** | | | | |
| Less than 1 year | $ 575,057 | $ 575,000 | $ 187,802,072 | $ 187,898,629 |
| 1–5 years | 57,762,035 | 53,155,753 | 147,637,953 | 147,916,989 |
| 5–10 years | – | – | 2,030,000 | 2,080,348 |
| More than 10 years | – | – | – | – |
| Mortgage-backed securities | – | – | 7,216 | 7,141 |
| | $ 58,337,092 | $ 53,730,753 | $ 337,477,241 | $ 337,903,107 |

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

**3. Investments (continued)**

The following table summarizes sale, call, and maturity activity of investment securities for the years ended December 31, 2016 and 2015.

| | Year Ended December 31, 2016 | 2015 |
|---|---|---|
| Held-to-maturity investment securities: | | |
| Proceeds from maturities | **$ 2,235,000** | $ 2,250,000 |
| Available-for-sale investment securities: | | |
| Proceeds from sales and maturities | **270,221,619** | 222,045,417 |
| Gross realized gains | **137,290** | 150,969 |
| Gross realized losses | **113** | 110,974 |

The following table sets forth the net unrealized gains (losses) on securities available-for-sale and the reclassification adjustments required for the years ended December 31, 2016 and 2015.

| | 2016 | 2015 |
|---|---|---|
| Net unrealized losses on investment securities available-for-sale, beginning of year | **$ (425,866)** | $ (41,291) |
| Net unrealized gains (losses) on investment securities available-for-sale, arising during the year | **15,481** | (344,580) |
| Reclassification adjustments for net gains on investment securities available-for-sale included in net income | **(137,177)** | (39,995) |
| Net unrealized losses on investment securities available-for-sale, end of year | **$ (547,562)** | $ (425,866) |

## 4. Loans

The following schedule summarizes loans outstanding as of December 31, 2016 and 2015.

| | International Program | U.S. Domestic Program | Total |
|---|---|---|---|
| **December 31, 2016** | | | |
| Loan balance | **$ 1,411,295,846** | **$ 329,827** | **$ 1,411,625,673** |
| Allowance for loan losses: | | | |
| General | **(25,052,471)** | **(23,188)** | **(25,075,659)** |
| Specific | – | – | – |
| Unamortized loan fees | **(10,682,210)** | – | **(10,682,210)** |
| Foreign currency exchange rate adjustment | **(55,027,169)** | – | **(55,027,169)** |
| Fair value of hedged items | **(151,854,451)** | – | **(151,854,451)** |
| Net loans outstanding | **$ 1,168,679,545** | **$ 306,639** | **$ 1,168,986,184** |
| **December 31, 2015** | | | |
| Loan balance | $ 1,324,777,048 | $ 358,401 | $ 1,325,135,449 |
| Allowance for loan losses: | | | |
| General | (19,918,734) | (23,188) | (19,941,922) |
| Specific | – | – | – |
| Unamortized loan fees | (9,661,632) | – | (9,661,632) |
| Foreign currency exchange rate adjustment | (43,446,961) | – | (43,446,961) |
| Fair value of hedged items | (51,606,468) | – | (51,606,468) |
| Net loans outstanding | $ 1,200,143,253 | $ 335,213 | $ 1,200,478,466 |

At December 31, 2016 and 2015, the International Program had outstanding loan commitments on signed loan agreements totaling $58,518,271 and $51,817,048, respectively. At those same dates, the U.S. Domestic Program did not have any outstanding loan commitments on signed loan agreements. The International Program also had loan agreements under development for an additional $159,191,105 as of December 31, 2016.

The Bank under certain circumstances offered below-market-rate loans. As of December 31, 2016 and 2015, the Bank had below-market-rate loans outstanding for the International Program of $39,675,001 and $43,173,661, respectively. At December 31, 2016 and 2015, the U.S. Domestic Program did not have any below-market-rate loans.

**4. Loans (continued)**

The following table presents the loan portfolio by sector as of December 31, 2016 and 2015.

| | December 31, | |
|---|---|---|
| | **2016** | **2015** |
| International Program: | | |
| Air quality | **$ 103,691,911** | $ 110,702,431 |
| Basic urban infrastructure | **36,380,546** | 36,853,882 |
| Clean energy: | | |
| Solar | **291,532,300** | 302,531,030 |
| Wind | **707,220,750** | 618,587,633 |
| Other | **4,823,929** | 4,225,910 |
| Public transportation | **31,865,601** | 3,687,700 |
| Storm drainage | **56,250,755** | 59,561,462 |
| Water and wastewater | **172,141,854** | 181,210,270 |
| Water conservation | **7,388,200** | 7,416,730 |
| Total International Program | **1,411,295,846** | 1,324,777,048 |
| U.S. Domestic Program | **329,827** | 358,401 |
| | **$ 1,411,625,673** | $ 1,325,135,449 |

**4. Loans (continued)**

The following table presents the loan portfolio by risk category as of December 31, 2016 and 2015. These risk categories are defined in Note 2, along with additional information on how the Bank evaluates credit quality.

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| **International Program** | | |
| Pass | **$ 1,394,063,313** | $ 1,324,777,048 |
| Special Mention | **–** | – |
| Substandard | **17,232,533** | – |
| Doubtful | **–** | – |
| Total International Program | **1,411,295,846** | 1,324,777,048 |
| **U.S. Domestic Program** | | |
| Pass | **–** | – |
| Special Mention | **329,827** | 358,401 |
| Substandard | **–** | – |
| Doubtful | **–** | – |
| Total U.S. Domestic Program | **329,827** | 358,401 |
| | **$ 1,411,625,673** | $ 1,325,135,449 |

There were no loans under the International Program on nonaccrual as of December 31, 2016 and 2015. The average impaired loan balance for the years ended December 31, 2016 and 2015 totaled $0 and $1,974,930, respectively. No interest income was recognized on the impaired loan for the year ended December 31, 2015. As of December 31, 2016 and 2015, the Bank had collateral from foreclosed loans reported as other assets of $2,978,307 and $4,786,389, respectively.

Under the U.S. Domestic Program, there was one loan on non-accrual as of December 31, 2016 with an outstanding balance of $329,827, and no loans on non-accrual as of December 31, 2015. The average impaired loan balance for the years ended December 31, 2016 and 2015 total $343,043 and $0, respectively. Interest income of $3,378 was recognized on the impaired loan for the year ended December 31, 2016.

**4. Loans (continued)**

An age analysis of past-due loans, including both accruing and non-accruing loans, as of December 31, 2016 and 2015, is shown in the following table.

| | Loans 30–89 Days Past Due | Loans 90 or More Days Past Due | Total Past-due Loans |
|---|---|---|---|
| **December 31, 2016** | | | |
| International Program | **$ –** | **$ –** | **$ –** |
| U.S. Domestic Program | **–** | **329,827** | **329,827** |
| | **$ –** | **$ 329,827** | **$ 329,827** |
| **December 31, 2015** | | | |
| International Program | $ – | $ – | $ – |
| U.S. Domestic Program | – | 358,401 | 358,401 |
| | $ – | $ 358,401 | $ 358,401 |

There were no loans past due 90 or more days accruing interest as of December 31, 2016 and 2015.

## 4. Loans (continued)

The following table summarizes the allowance for loan losses by classification as of December 31, 2016 and 2015.

| | Allowance for Loan Losses | | | |
|---|---|---|---|---|
| | General Allowance | Specific Allowance | Total | Total Loans Outstanding |
| **December 31, 2016** | | | | |
| International Program: | | | | |
| Private: | | | | |
| Construction | **$ 10,417,904** | **$ –** | **$ 10,417,904** | **$ 226,218,309** |
| Operation | **12,741,894** | **–** | **12,741,894** | **806,542,895** |
| Public | **1,441,539** | **–** | **1,441,539** | **288,307,752** |
| Public-private | **451,134** | **–** | **451,134** | **90,226,890** |
| Total International Program | **25,052,471** | **–** | **25,052,471** | **1,411,295,846** |
| U.S. Domestic Program | **23,188** | **–** | **23,188** | **329,827** |
| | **$ 25,075,659** | **$ –** | **$ 25,075,659** | **$ 1,411,625,673** |
| **December 31, 2015** | | | | |
| International Program: | | | | |
| Private: | | | | |
| Construction | $ 10,300,322 | $ – | $ 10,300,322 | $ 258,088,762 |
| Operation | 9,618,412 | – | 9,618,412 | 669,139,482 |
| Public | – | – | – | 305,588,205 |
| Public-private | – | – | – | 91,960,599 |
| Total International Program | 19,918,734 | – | 19,918,734 | 1,324,777,048 |
| U.S. Domestic Program | 23,188 | – | 23,188 | 358,401 |
| | $ 19,941,922 | $ – | $ 19,941,922 | $ 1,325,135,449 |

Public-private refers to loans made to private-sector borrowers and backed by public-sector federal tax revenue.

**4. Loans (continued)**

The following schedule summarizes the allowance for loan losses for the years ended December 31, 2016 and 2015.

| | Allowance for Loan Losses | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Loan Loss Provisions: Specific | Loan Loss Provisions: General | Loan (Charge-offs) Recoveries | Ending Balance |
| **December 31, 2016** | | | | | |
| International Program: | | | | | |
| Private: | | | | | |
| Construction | **$ 10,300,322** | **$ –** | **$ 117,582** | **$ –** | **$ 10,417,904** |
| Operation | **9,618,412** | **–** | **3,123,482** | **–** | **12,741,894** |
| Public | **–** | **–** | **1,441,539** | **–** | **1,441,539** |
| Public-private | **–** | **–** | **451,134** | **–** | **451,134** |
| Total International Program | **19,918,734** | **–** | **5,133,737** | **–** | **25,052,471** |
| U.S. Domestic Program | **23,188** | **–** | **–** | **–** | **23,188** |
| | **$ 19,941,922** | **$ –** | **$ 5,133,737** | **$ –** | **$ 25,075,659** |
| **December 31, 2015** | | | | | |
| International Program: | | | | | |
| Private: | | | | | |
| Construction | $ 5,528,110 | $ – | $ 4,772,212 | $ – | $ 10,300,322 |
| Operation | 5,827,518 | – | 3,790,894 | – | 9,618,412 |
| Public | – | – | (3,852) | 3,852 | – |
| Public-private | – | – | – | – | – |
| Total International Program | 11,355,628 | – | 8,559,254 | 3,852 | 19,918,734 |
| U.S. Domestic Program | 23,188 | – | – | – | 23,188 |
| | $ 11,378,816 | $ – | $ 8,559,254 | $ 3,852 | $ 19,941,922 |

## 5. Other Assets and Other Liabilities

The following table presents the gross and net balances of other assets and other liabilities, including the result of master netting arrangements for derivatives with certain swap counterparties, at December 31, 2016 and 2015.

| | Gross Amount | Master Netting Arrangements | Net Amount |
|---|---|---|---|
| **December 31, 2016** | | | |
| **Other assets** | | | |
| Cross-currency interest rate swaps | **$ 255,338,489** | **$ (27,619,486)** | **$ 227,719,003** |
| Interest rate swaps | **12,513,231** | **(8,447,465)** | **4,065,766** |
| Collateral from swap counterparties | **(135,490,000)** | **–** | **(135,490,000)** |
| Credit valuation adjustment for swaps | **(1,243,752)** | **–** | **(1,243,752)** |
| Other real estate owned | **2,978,307** | **–** | **2,978,307** |
| Total other assets | **$ 134,096,275** | **$ (36,066,951)** | **$ 98,029,324** |
| **Other liabilities** | | | |
| Cross-currency interest rate swaps | **$ –** | **$ –** | **$ –** |
| Interest rate swaps | **–** | **–** | **–** |
| Total other liabilities | **$ –** | **$ –** | **$ –** |
| **December 31, 2015** | | | |
| **Other assets** | | | |
| Cross-currency interest rate swaps | $ 136,668,543 | $ (29,973,461) | $ 106,695,082 |
| Interest rate swaps | 17,780,265 | (2,053,020) | 15,727,245 |
| Collateral from swap counterparties | (67,600,000) | – | (67,600,000) |
| Credit valuation adjustment for swaps | (504,961) | – | (504,961) |
| Other real estate owned | 4,786,389 | – | 4,786,389 |
| Total other assets | $ 91,130,236 | $ (32,026,481) | $ 59,103,755 |
| **Other liabilities** | | | |
| Cross-currency interest rate swaps | $ 2,395,365 | $ – | $ 2,395,365 |
| Interest rate swaps | 3,815,603 | – | 3,815,603 |
| Total other liabilities | $ 6,210,968 | $ – | $ 6,210,968 |

## 6. Debt

The following table summarizes the notes payable and other borrowings as of December 31, 2016 and 2015.

| | | | December 31, 2016 | | | | |
|---|---|---|---|---|---|---|---|
| **Issue Date** | **Maturity Date** | **Fixed Rate** | **Principal Amount** | **Unamortized Premium/ (Discount)** | **Unamortized Debt Issuance Costs** | **Fair Value of Hedged Items** | **Net Debt** |
| **Notes Payable** | | | | | | | |
| USD Issuance | | | | | | | |
| 02/11/10 | 02/11/20 | 4.375% | **$ 250,000,000** | **$ (203,000)** | **$ (502,811)** | **$ 11,844,826** | **$ 261,139,015** |
| 10/26/12 | 10/26/22 | 2.400 | **250,000,000** | **(500,472)** | **(865,430)** | **(3,429,048)** | **245,205,050** |
| 12/17/12 | 10/26/22 | 2.400 | **180,000,000** | **(2,202,230)** | **(548,185)** | **(4,130,413)** | **173,119,172** |
| 12/17/12 | 12/17/30 | 3.300 | **50,000,000** | **–** | **(239,978)** | **(888,004)** | **48,872,018** |
| 10/10/13 | 10/10/18 | 2.300 | **300,000,000** | **(400,402)** | **(595,962)** | **668,405** | **299,672,041** |
| CHF Issuance | | | | | | | |
| 04/30/15 | 04/30/25 | 0.250 | **128,706,754** | **666,880** | **(692,235)** | **(1,134,218)** | **127,547,181** |
| Total Notes Payable | | | **1,158,706,754** | **(2,639,224)** | **(3,444,601)** | **2,931,548** | **1,155,554,477** |
| **Other Borrowings** | | | | | | | |
| 08/15/13 | 06/30/17 | 1.900 | **2,631,000** | – | – | – | **2,631,000** |
| 08/15/13 | 12/30/17 | 1.900 | **2,631,000** | – | – | – | **2,631,000** |
| 08/15/13 | 06/30/18 | 1.900 | **2,631,000** | – | – | – | **2,631,000** |
| 08/15/13 | 12/30/18 | 1.900 | **600,467** | – | – | – | **600,467** |
| 04/11/14 | 12/30/18 | 1.900 | **2,030,533** | – | – | – | **2,030,533** |
| 04/11/14 | 06/30/19 | 1.900 | **2,631,000** | – | – | – | **2,631,000** |
| 04/11/14 | 12/30/19 | 1.900 | **2,632,000** | – | – | – | **2,632,000** |
| 04/11/14 | 06/30/20 | 1.900 | **526,785** | – | – | – | **526,785** |
| 08/14/14 | 06/30/20 | 1.900 | **2,105,215** | – | – | – | **2,105,215** |
| 08/14/14 | 12/30/20 | 1.900 | **2,632,000** | – | – | – | **2,632,000** |
| 08/14/14 | 06/30/21 | 1.900 | **1,008,985** | – | – | – | **1,008,985** |
| 02/13/15 | 06/30/21 | 1.900 | **1,623,015** | – | – | – | **1,623,015** |
| 02/13/15 | 12/30/21 | 1.900 | **1,470,635** | – | – | – | **1,470,635** |
| 07/29/15 | 12/30/21 | 1.900 | **1,161,365** | – | – | – | **1,161,365** |
| 07/29/15 | 06/30/22 | 1.900 | **266,455** | – | – | – | **266,455** |
| 09/16/16 | 06/30/22 | 1.900 | **2,216,528** | – | – | – | **2,216,528** |
| Total Other Borrowings | | | **28,797,983** | – | – | – | **28,797,983** |
| | | | **$ 1,187,504,737** | **$ (2,639,224)** | **$ (3,444,601)** | **$ 2,931,548** | **$1,184,352,460** |

## 6. Debt (continued)

| | | | December 31, 2015 | | | | |
|---|---|---|---|---|---|---|---|
| Issue Date | Maturity Date | Fixed Rate | Principal Amount | Unamortized Premium/ (Discount) | Unamortized Debt Issuance Costs | Fair Value of Hedged Items | Net Debt |
| **Notes Payable** | | | | | | | |
| USD Issuance | | | | | | | |
| 02/11/10 | 02/11/20 | 4.375% | $ 250,000,000 | $ (268,250) | $ (664,429) | $ 16,479,919 | $ 265,547,240 |
| 10/26/12 | 10/26/22 | 2.400 | 250,000,000 | (586,472) | (1,014,144) | (1,949,072) | 246,450,312 |
| 12/17/12 | 10/26/22 | 2.400 | 180,000,000 | (2,580,656) | (642,384) | (3,344,004) | 173,432,956 |
| 12/17/12 | 12/17/30 | 3.300 | 50,000,000 | – | (257,167) | (575,548) | 49,167,285 |
| 10/10/13 | 10/10/18 | 2.300 | 300,000,000 | (459,503) | (931,716) | 1,300,346 | 299,909,127 |
| CHF Issuance | | | | | | | |
| 04/30/15 | 04/30/25 | 0.250 | 128,706,754 | 743,365 | (775,303) | (1,731,555) | 126,943,261 |
| Total Notes Payable | | | 1,158,706,754 | (3,151,516) | (4,285,143) | 10,180,086 | 1,161,450,181 |
| **Other Borrowings** | | | | | | | |
| 03/07/13 | 06/30/16 | 1.900 | 1,653,972 | – | – | – | 1,653,972 |
| 08/15/13 | 06/30/16 | 1.900 | 977,028 | – | – | – | 977,028 |
| 08/15/13 | 12/30/16 | 1.900 | 2,631,000 | – | – | – | 2,631,000 |
| 08/15/13 | 06/30/17 | 1.900 | 2,631,000 | – | – | – | 2,631,000 |
| 08/15/13 | 12/30/17 | 1.900 | 2,631,000 | – | – | – | 2,631,000 |
| 08/15/13 | 06/30/18 | 1.900 | 2,631,000 | – | – | – | 2,631,000 |
| 08/15/13 | 12/30/18 | 1.900 | 600,467 | – | – | – | 600,467 |
| 04/11/14 | 12/30/18 | 1.900 | 2,030,533 | – | – | – | 2,030,533 |
| 04/11/14 | 06/30/19 | 1.900 | 2,631,000 | – | – | – | 2,631,000 |
| 04/11/14 | 12/30/19 | 1.900 | 2,632,000 | – | – | – | 2,632,000 |
| 04/11/14 | 06/30/20 | 1.900 | 526,785 | – | – | – | 526,785 |
| 08/14/14 | 06/30/20 | 1.900 | 2,105,215 | – | – | – | 2,105,215 |
| 08/14/14 | 12/30/20 | 1.900 | 2,632,000 | – | – | – | 2,632,000 |
| 08/14/14 | 06/30/21 | 1.900 | 1,008,985 | – | – | – | 1,008,985 |
| 02/13/15 | 06/30/21 | 1.900 | 1,623,015 | – | – | – | 1,623,015 |
| 02/13/15 | 12/30/21 | 1.900 | 1,470,635 | – | – | – | 1,470,635 |
| 07/29/15 | 12/30/21 | 1.900 | 1,161,365 | – | – | – | 1,161,365 |
| 07/29/15 | 06/30/22 | 1.900 | 266,455 | – | – | – | 266,455 |
| Total Other Borrowings | | | 31,843,455 | – | – | – | 31,843,455 |
| | | | $ 1,190,550,209 | $ (3,151,516) | $ (4,285,143) | $ 10,180,086 | $1,193,293,636 |

**6. Debt (continued)**

**Notes Payable**

The notes payable are unsecured, rank equally with all other unsecured indebtedness, and cannot be redeemed prior to their maturity, at which time they will be redeemed at 100% of their principal amount. Interest payments are due semiannually.

The fair value of the hedges relating to interest rate swaps on a portion of the notes payable was reported at December 31, 2016 as other assets of $4,065,766 and other liabilities of $0 and at December 31, 2015 as other assets of $15,727,245 and other liabilities of $3,815,603. The fair value of the hedges relating to cross-currency interest rate swaps on notes payable not denominated in U.S. dollars was reported at December 31, 2016 as other assets of ($2,309,109) and at December 31, 2015 as other liabilities of $2,395,365. For additional information on the fair value of financial instruments and derivatives, see Notes 11 and 12.

**Other Borrowings**

On November 8, 2012, the Bank signed a loan commitment with another development bank to borrow up to $50 million to fund eligible projects in Mexico. This loan amortizes semiannually, with the first principal payment paid on December 30, 2015 and final principal payment due on December 30, 2024. As of December 31, 2016 and 2015, the outstanding balance was $28,797,983 and $31,843,455, respectively.

The following table summarizes the maturities of the notes payable and other borrowings as of December 31, 2016 and 2015.

| | December 31, | |
|---|---|---|
| | **2016** | **2015** |
| Less than 1 year | **$ 5,262,000** | $ 5,262,000 |
| 1–2 years | **305,262,000** | 5,262,000 |
| 2–3 years | **5,263,000** | 305,262,000 |
| 3–4 years | **255,264,000** | 5,263,000 |
| 4–5 years | **5,264,000** | 255,264,000 |
| 5–10 years | **561,189,737** | 564,237,209 |
| More than 10 years | **50,000,000** | 50,000,000 |
| Total | **$ 1,187,504,737** | $ 1,190,550,209 |

**6. Debt (continued)**

The following table summarizes the short-term and long-term debt as of December 31, 2016 and 2015.

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| Short-term debt: | | |
| Notes payable | **$ –** | $ – |
| Other borrowings | **5,262,000** | 5,262,000 |
| Total short-term debt | **5,262,000** | 5,262,000 |
| | | |
| Long-term debt: | | |
| Notes payable | **1,158,706,754** | 1,158,706,754 |
| Other borrowings | **23,535,983** | 26,581,455 |
| Total long-term debt | **1,182,242,737** | 1,185,288,209 |
| Total debt | **$ 1,187,504,737** | $ 1,190,550,209 |

## 7. Equity

### Subscribed Capital

At December 31, 2016 and 2015, the Bank had authorized and subscribed 600,000 and 300,000 shares of capital stock, respectively, with a par value of $10,000 per share. As defined in the Charter, capital includes unqualified and qualified subscribed shares. Unqualified subscribed shares have either been funded or authorized for purchase by the subscribing country. Capital is further classified as callable or paid-in capital at December 31, 2016 and 2015 as follows.

| | Mexico | | United States | | Total | |
|---|---|---|---|---|---|---|
| | **Shares** | **Dollars** | **Shares** | **Dollars** | **Shares** | **Dollars** |
| **December 31, 2016** | | | | | | |
| Subscribed capital | 300,000 | $ 3,000,000,000 | 300,000 | $ 3,000,000,000 | 600,000 | $6,000,000,000 |
| Less: | | | | | | |
| Qualified callable capital | (121,833.3333) | (1,218,333,333) | (127,500) | (1,275,000,000) | (249,333.3333) | (2,493,333,333) |
| Unqualified callable capital | (133,166.6667) | (1,331,666,667) | (127,500) | (1,275,000,000) | (260,666.6667) | (2,606,666,667) |
| Qualified paid-in capital | (21,500) | (215,000,000) | (22,500) | (225,000,000) | (44,000) | (440,000,000) |
| Total funded paid-in capital | 23,500 | 235,000,000 | 22,500 | 225,000,000 | 46,000 | 460,000,000 |
| Less transfer to General Reserve for Domestic Programs | – | (22,500,000) | – | (22,500,000) | – | (45,000,000) |
| Total paid-in capital | 23,500 | $ 212,500,000 | 22,500 | $ 202,500,000 | 46,000 | $ 415,000,000 |
| **December 31, 2015** | | | | | | |
| Subscribed capital | 150,000 | $ 1,500,000,000 | 150,000 | $ 1,500,000,000 | 300,000 | $3,000,000,000 |
| Less callable capital | (127,500) | (1,275,000,000) | (127,500) | (1,275,000,000) | (255,000) | (2,550,000,000) |
| Total funded paid-in capital | 22,500 | 225,000,000 | 22,500 | 225,000,000 | 45,000 | 450,000,000 |
| Less transfer to General Reserve for Domestic Programs | – | (22,500,000) | – | (22,500,000) | – | (45,000,000) |
| Total paid-in capital | 22,500 | $ 202,500,000 | 22,500 | $ 202,500,000 | 45,000 | $ 405,000,000 |

**7. Equity (continued)**

On May 6, 2016, Mexico submitted its letter of subscription to conditionally subscribe to 150,000 additional shares of capital stock with a par value of US$10,000 per share, subject to the necessary legal requirements and availability of appropriations. The capital stock is further classified as 22,500 qualified paid-in capital shares or US$225,000,000 and 127,500 qualified callable shares or US$1,275,000,000. On September 26, 2016, Mexico made its first contribution of the additional paid-in capital of $10,000,000 or 1,000 shares of paid-in capital and unqualified 5,666.6667 shares of callable capital.

On September 1, 2016, the United States submitted its letter of subscription to conditionally subscribe to 150,000 additional shares of capital stock with a par value of US$10,000 per share, subject to the necessary legislation and availability of appropriations. The capital stock is further classified as 22,500 qualified paid-in capital shares or US$225,000,000 and 127,500 qualified callable shares or US$1,275,000,000.

The subscriptions of members to paid-in capital and callable capital stock shall be in several installments, effective on or before December 31, 2016 through December 31, 2022, or such later dates as the Board of Directors shall determine. The callable portion of the subscription for capital shares of the Bank will be subject to call only when required to meet obligations, as outlined in Article II, Section 3(d), of Chapter II of the Charter.

## 7. Equity (continued)

### Retained Earnings

Retained earnings are classified as designated, reserved, and undesignated by program, as follows:

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| **Designated retained earnings** | | |
| International Program: | | |
| Water Conservation Investment Fund (WCIF) | **$ 918,920** | $ 1,039,728 |
| Technical Assistance Program (TAP) | **3,728,057** | 4,055,139 |
| Community Assistance Program (CAP) | **8,811,470** | 9,241,103 |
| Total International Program | **13,458,447** | 14,335,970 |
| U.S. Domestic Program | **(1,678,313)** | (1,415,178) |
| Total designated retained earnings | **11,780,134** | 12,920,792 |
| **Reserved retained earnings** | | |
| International Program: | | |
| Debt Service Reserve | **30,800,868** | 24,609,470 |
| Operating Expenses Reserve | **13,372,300** | 10,396,093 |
| Special Reserve | **30,000,000** | 30,000,000 |
| Capital Preservation Reserve | **40,370,311** | 34,654,799 |
| Total International Program | **114,543,479** | 99,660,362 |
| U.S. Domestic Program: | | |
| Special Reserve | **9,895** | 10,752 |
| Total reserved retained earnings | **114,553,374** | 99,671,114 |
| **Undesignated retained earnings** | | |
| International Program | **45,058,709** | 39,394,125 |
| Total undesignated retained earnings | **45,058,709** | 39,394,125 |
| Total retained earnings | **$ 171,392,217** | $ 151,986,031 |
| **Retained earnings by program** | | |
| International Program | **$ 173,060,635** | $ 153,390,457 |
| U.S. Domestic Program | **(1,668,418)** | (1,404,426) |
| Total retained earnings | **$ 171,392,217** | $ 151,986,031 |

Additional information regarding the reserved funds and each program listed above is provided in Notes 2 and 9, respectively.

## 7. Equity (continued)

### Accumulated Other Comprehensive Income

The following table presents the changes in accumulated other comprehensive income (loss) for years ended December 31, 2016 and 2015.

| | Beginning Balance | Period Activity | Ending Balance |
|---|---|---|---|
| **December 31, 2016** | | | |
| Unrealized loss on available-for-sale investment securities | **$ (425,865)** | **$ (121,696)** | **$ (547,561)** |
| Foreign currency translation adjustment | **214,219** | **158,889** | **373,108** |
| Unrealized gain (loss) on hedging activities: | | | |
| Foreign currency translation adjustment | **(43,446,961)** | **(11,580,208)** | **(55,027,169)** |
| Fair value of cross-currency interest rate swaps | **50,844,174** | **20,324,726** | **71,168,900** |
| Net unrealized gain on hedging activities | **7,397,213** | **8,744,518** | **16,141,731** |
| Total accumulated other comprehensive income | **$ 7,185,567** | **$ 8,781,711** | **$ 15,967,278** |
| **December 31, 2015** | | | |
| Unrealized loss on available-for-sale investment securities | $ (41,291) | $ (384,574) | $ (425,865) |
| Foreign currency translation adjustment | 66,326 | 147,893 | 214,219 |
| Unrealized gain (loss) on hedging activities: | | | |
| Foreign currency translation adjustment | (31,945,583) | (11,501,378) | (43,446,961) |
| Fair value of cross-currency interest rate swaps | 31,726,530 | 19,117,644 | 50,844,174 |
| Net unrealized gain (loss) on hedging activities | (219,053) | 7,616,266 | 7,397,213 |
| Total accumulated other comprehensive income (loss) | $ (194,018) | $ 7,379,585 | $ 7,185,567 |

## 8. Domestic Programs

As specified in the Charter, 10% of each country's initial subscription of capital stock was set aside to finance community adjustment and investment programs in support of the purposes of NAFTA. In accordance with the Charter, the Board of Directors approved transfers in prior years of $45,000,000, equal to 10% of the initial paid-in capital of $450,000,000 from the initial subscription, to the General Reserve to support these programs. To further clarify operations related to these programs, the Bank entered into a Memorandum of Understanding (MOU) with each country. In accordance with the MOUs, the U.S. and Mexican programs are administered independently.

**8. Domestic Programs (continued)**

**Mexico**

The MOU with Mexico specified that 10% of the initial paid-in capital from its initial capital subscription and the related earnings be set aside for the community adjustment and investment program endorsed by Mexico. The Government of Mexico instituted its domestic program, titled *Programa Complementario de Apoyo a Comunidades y Empresas* (Mexican Domestic Program), through the offices of the SHCP. In June 1996, the SHCP entered into a mandate agreement with Banobras to receive and administer the funds allocated for this program. The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999. Accordingly, the activities of the Mexican Domestic Program are not reflected as operations of the Bank.

**United States**

The MOU with the U.S. Government specified that 10% of the initial paid-in capital from its initial capital subscription and the related earnings be set aside for the U.S. Community Adjustment and Investment Program (U.S. Domestic Program). The Bank provides financing endorsed by the Finance Committee appointed by the U.S. Government for that purpose.

In accordance with the Charter and MOU with the United States, net assets of the Bank in the amounts of $792,372 and $1,622,830 were designated for the U.S. Domestic Program at December 31, 2016 and 2015, respectively. The revenue related to these amounts for the years ended December 31, 2016 and 2015 were $5,161 and $20,463, respectively. Additionally, expenses directly related to the operation of the U.S. Domestic Program of $268,461 and $285,955, are included in the operations of the Bank for the years ended December 31, 2016 and 2015, respectively. All expenses and disbursements are paid out of the U.S. Domestic Program funds. Deficit retained earnings on the U.S. Domestic Program capital funds as of December 31, 2016 and 2015 were $1,668,418 and $1,404,426, respectively. Under the U.S. Domestic Program, $513,695 in cash and cash equivalents was available for disbursement as of December 31, 2016.

In January 2009, the Finance Committee approved a Targeted Grant Program (TGP) to be funded with the remaining balance of the U.S. Domestic Program's allocated paid-in capital. As of December 31, 2016 and 2015, the U.S. Domestic Program's allocated paid-in capital totaled $2,460,790 and $3,027,256, respectively. For the years ended December 31, 2016 and 2015, $566,466 and $1,309,820, respectively, were disbursed through the TGP. These disbursements were reported as a deduction from allocated paid-in capital.

**9. Program Activities**

Program activities are comprised of the following:

| | Year Ended December 31, 2016 | 2015 |
|---|---|---|
| Program income: | | |
| EPA grant | **$ 843,300** | $ 832,143 |
| Total program income | **843,300** | 832,143 |
| | | |
| Program expenses: | | |
| EPA grant administration | **(843,300)** | (832,143) |
| Technical Assistance Program | **(537,557)** | (1,179,090) |
| Community Assistance Program | **(429,633)** | (1,436,053) |
| Water Conservation Investment Fund | **(120,808)** | (2,257,725) |
| Total program expenses | **(1,931,298)** | (5,705,011) |
| Net program expenses | **$ (1,087,998)** | $ (4,872,868) |

**EPA Grants**

The Bank administers grant funds from EPA through the Border Environment Infrastructure Fund (BEIF). EPA grant awards since the initial grant made in April 1997 to December 31, 2016 total $692,812,849. Under the terms of the grants, the Bank reviews and submits prospective projects to EPA, which approves the projects. EPA then disburses funds to the Bank, which directs the grant monies to the specified project. The Bank also oversees progress and compliance requirements for EPA and receives an allocation of the EPA grant funds for administrative expenses incurred.

As of December 31, 2016, EPA has approved project funding proposed by the Bank totaling $656,940,544, of which $602,857,358 has been disbursed through the Bank. The Bank recognized $843,300 and $832,143 as reimbursement of expenses incurred for the years ended December 31, 2016 and 2015, respectively. These funds have been recorded as program revenue and expenses in the consolidated statements of income.

## 9. Program Activities (continued)

### Technical Assistance Program (TAP)

The Bank uses a portion of its retained earnings as authorized by the Board of Directors to offer technical assistance and training to project sponsors for the purpose of strengthening their financial performance and ensuring the long-term sustainability of their infrastructure. Through the TAP, assistance is provided in three categories: project development, institutional capacity-building measures, and sector studies to identify needs and generate knowledge about a new sector or technology. For the years ended December 31, 2016 and 2015, $327,082 and $849,195, respectively, was disbursed under this program. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

As part of its technical assistance program, the Utility Management Institute (UMI) provides water utility managers and their staff with an opportunity for ongoing professional development aimed at enhancing their managerial and financial skills. For the years ended December 31, 2016 and 2015, $210,475 and $329,895, respectively, was expended under this program.

### Water Conservation Investment Fund (WCIF)

In August 2002, the Board of Directors established the WCIF to finance water conservation projects in the U.S.-Mexico border region and designated $80,000,000 of the Bank's undesignated retained earnings to the program. Of that amount, $40,000,000 was reserved exclusively for water conservation projects in each country. For the years ended December 31, 2016 and 2015, $120,808 and $2,257,725 respectively, were disbursed under this fund. As of December 31, 2016, cumulative disbursements total $38,035,477 for the United States and $39,990,407 for Mexico. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

In May 2013, the Board agreed to close out the WCIF and transfer any uncommitted funds to the CAP program. In December 2013, a cumulative total of $1,055,196 in uncommitted WCIF funds was transferred to the CAP program.

## 9. Program Activities (continued)

### Community Assistance Program (CAP)

In February 2011, the Board of Directors approved a grant program to support public projects in all sectors eligible for Bank financing. The CAP program is funded from the Bank's undesignated retained earnings as authorized by the Board. As of December 31, 2016, a cumulative total of $11,473,415 has been allocated to the CAP. For the years ended December 31, 2016 and 2015, $429,633 and $1,436,053, respectively, were disbursed under this program. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

## 10. Employee Benefits

### 401(a) Retirement Plan

The Bank has a 401(a) Retirement Plan for its employees. This plan provides for employee and nondiscretionary employer contributions. For the years ended December 31, 2016 and 2015, the Bank expended $751,187 and $604,386, respectively, relating to the plan.

### Retiree Health Insurance Plan

The Bank has a retiree health insurance plan for qualifying employees based on number of years of service and age. Qualified retirees may purchase group health insurance coverage at the current employee rate subject to plan limits.

## 11. Fair Value of Financial Instruments

Information on how the Bank measures fair value and classifies the levels of the fair value inputs is provided in Note 2.

### Cash and Cash Equivalents

The carrying amounts for cash and cash equivalents approximate their fair value.

**11. Fair Value of Financial Instruments (continued)**

**Securities Held-to-Maturity**

Securities classified as held-to-maturity are reported at amortized costs. The fair value of these securities is estimated using Level 2 observable inputs. For these securities, the Bank obtains fair value measurements from an independent pricing service which are based on prices quoted for a similar instrument.

**Securities Available-for-Sale**

Securities classified as available-for-sale are reported at fair value using Level 1 and Level 2 observable inputs. For these securities, the Bank obtains fair value measurements from an independent pricing service, which are based on prices quoted for the exact or like-kind instrument.

**Loans Receivable and Interest Receivable**

The fair value of loans is estimated based on Level 2 observable inputs using discounted cash flow analyses and interest rates currently being offered for loans made by the Bank with similar terms to borrowers of similar credit quality, net of allowance for loan loss. The fair value of nonaccrual loans is estimated to equal the aggregate net realizable value of the underlying collateral and guaranties. The carrying amount of accrued interest approximates its fair value. This valuation does not consider liquidity discounts currently being used by certain market participants, since measuring their impact would not be cost-beneficial for the Bank, given the nature of its loan portfolio.

**Hedged Items for Loans**

Hedged items for loans are reported at fair value using Level 3 unobservable inputs. The fair value of these hedged items is estimated by discounting each cash flow stream using the benchmark swap curve of the contractual currency and converting the resulting net present value at the spot exchange rate, as well as using external pricing models and counterparty pricing. Mexican-peso cash flows are discounted using the Mexico Benchmark Interbank Deposit Rate (TIIE) 28-day swap curve. U.S.-dollar cash flows are discounted using the USD Overnight Index Swap (OIS) curve.

**11. Fair Value of Financial Instruments (continued)**

**Cross-currency Interest Rate Swaps**

Cross-currency interest rate swaps are reported at fair value using Level 3 unobservable inputs. The fair value of these swaps is estimated based on discounting procedures, whereby each cash flow stream is discounted using the benchmark swap curve of the respective currency and converting the resulting net present value at the spot exchange rate, as well as external pricing models and counterparty pricing. The Bank's cross-currency interest rate swaps are all Mexican-peso for U.S.-dollar operations except for one Swiss-franc for U.S.-dollar operation in connection with a debt issuance in Swiss francs. Mexican-peso cash flows are discounted using the TIIE 28-day swap curve. Swiss franc (CHF) cash flows are discounted using the CHF swap curve. U.S.-dollar cash flows are discounted using the USD OIS curve.

**Interest Rate Swaps**

Interest rate swaps are reported at fair value using Level 3 unobservable inputs. The fair value of these swaps is estimated based on discounting procedures, whereby each cash flow stream is discounted using the USD OIS curve, as well as external pricing models and counterparty pricing.

**Other Real Estate Owned**

Other real estate owned is reported at fair value using Level 3 unobservable inputs based on customized discounting criteria.

**Debt and Accrued Interest Payable**

Notes payable and other borrowings are carried at amortized cost. The fair value of the debt is estimated by discounting the cash flow stream using the USD OIS curve. The carrying amount of accrued interest payable approximates its fair value.

**Hedged Items for Notes Payable**

Hedged items for notes payable are reported at fair value using Level 3 unobservable inputs. The fair value of the hedged items is estimated based on discounting procedures, whereby each cash flow stream is discounted using the USD OIS curve for USD issuances and the CHF swap curve for the Swiss franc issuance, as well as on external pricing models and counterparty pricing.

### 11. Fair Value of Financial Instruments (continued)

The following table summarizes the carrying amounts and fair value of the Bank's financial instruments:

| | December 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Estimated Fair Value** | **Carrying Amount** | **Estimated Fair Value** |
| **Assets** | | | | |
| Cash and cash equivalents | **$ 151,727,469** | **$ 151,727,469** | $ 114,979,878 | $ 114,979,878 |
| Held-to-maturity securities | **53,782,155** | **57,523,432** | 53,730,753 | 58,337,092 |
| Available-for-sale securities | **306,562,226** | **306,562,226** | 337,477,241 | 337,477,241 |
| Loans, net | **1,168,986,184** | **1,200,398,847** | 1,200,478,466 | 1,222,140,888 |
| Interest receivable | **26,806,845** | **26,806,845** | 11,226,560 | 11,226,560 |
| Cross-currency interest rate swaps | **227,719,003** | **227,719,003** | 106,695,082 | 106,695,082 |
| Interest rate swaps | **4,065,766** | **4,065,766** | 15,727,245 | 15,727,245 |
| Other real estate owned | **2,978,307** | **2,978,307** | 4,786,389 | 4,786,389 |
| **Liabilities** | | | | |
| Accrued interest payable | **16,593,968** | **16,593,968** | 9,079,465 | 9,079,465 |
| Short-term debt | **5,262,000** | **5,262,000** | 5,262,000 | 5,262,000 |
| Cross-currency interest rate swaps | – | – | 2,395,365 | 2,395,365 |
| Interest rate swaps | – | – | 3,815,603 | 3,815,603 |
| Long-term debt, net | **1,176,158,912** | **1,178,937,246** | 1,177,851,550 | 1,182,058,243 |

## 11. Fair Value of Financial Instruments (continued)

The Bank's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015 are summarized in the following table by the valuation level of the inputs used to measure fair value. Additional information on how the Bank measures and classifies the levels of fair-value inputs is provided in Note 2.

| | Fair Value Measurements Using | | | Total |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Fair Value** |
| **December 31, 2016** | | | | |
| **Assets** | | | | |
| Available-for-sale (AFS) securities: | | | | |
| U.S. government securities | **$ 117,325,855** | **$ –** | **$ –** | **$ 117,325,855** |
| U.S. agency securities | **–** | **62,532,435** | **–** | **62,532,435** |
| Corporate debt securities | **–** | **80,290,282** | **–** | **80,290,282** |
| Other fixed-income securities | **–** | **34,857,699** | **–** | **34,857,699** |
| Mexican government securities (UMS) | **–** | **11,555,955** | **–** | **11,555,955** |
| Mortgage-backed securities | **–** | **–** | **–** | **–** |
| Total AFS securities | **117,325,855** | **189,236,371** | **–** | **306,562,226** |
| Cross-currency interest rate swaps | **–** | **–** | **227,719,003** | **227,719,003** |
| Interest rate swaps | **–** | **–** | **4,065,766** | **4,065,766** |
| Hedged items for loans | **–** | **–** | **(151,854,451)** | **(151,854,451)** |
| Total assets at fair value | **$ 117,325,855** | **$ 189,236,371** | **$ 79,930,318** | **$ 386,492,544** |
| | | | | |
| **Liabilities** | | | | |
| Cross-currency interest rate swaps | **$ –** | **$ –** | **$ –** | **$ –** |
| Interest rate swaps | **–** | **–** | **–** | **–** |
| Hedged items for notes payable | **–** | **–** | **2,931,548** | **2,931,548** |
| Total liabilities at fair value | **$ –** | **$ –** | **$ 2,931,548** | **$ 2,931,548** |

## 11. Fair Value of Financial Instruments (continued)

| | Fair Value Measurements Using | | | Total |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Fair Value |
| **December 31, 2015** | | | | |
| **Assets** | | | | |
| Available-for-sale (AFS) securities: | | | | |
| U.S. government securities | $ 134,420,141 | $ – | $ – | $ 134,420,141 |
| U.S. agency securities | – | 71,594,343 | – | 71,594,343 |
| Corporate debt securities | – | 86,413,921 | – | 86,413,921 |
| Other fixed-income securities | – | 31,404,320 | – | 31,404,320 |
| Mexican government securities (UMS) | – | 13,637,300 | – | 13,637,300 |
| Mortgage-backed securities | – | 7,216 | – | 7,216 |
| Total AFS securities | 134,420,141 | 203,057,100 | – | 337,477,241 |
| Cross-currency interest rate swaps | – | – | 106,695,082 | 106,695,082 |
| Interest rate swaps | – | – | 15,727,245 | 15,727,245 |
| Hedged items for loans | – | – | (51,606,468) | (51,606,468) |
| Total assets at fair value | $ 134,420,141 | $ 203,057,100 | $ 70,815,859 | $ 408,293,100 |
| | | | | |
| **Liabilities** | | | | |
| Cross-currency interest rate swaps | $ – | $ – | $ 2,395,365 | $ 2,395,365 |
| Interest rate swaps | – | – | 3,815,603 | 3,815,603 |
| Hedged items for notes payable | – | – | 10,180,086 | 10,180,086 |
| Total liabilities at fair value | $ – | $ – | $ 16,391,054 | $ 16,391,054 |

The following table summarizes the changes to the financial assets and liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) during the years ended December 31, 2016 and 2015. Additional information on how the Bank measures fair value is provided in Note 2.

## 11. Fair Value of Financial Instruments (continued)

| | Fair Value of Level 3 Instruments | | |
|---|---|---|---|
| | Cross-currency Interest Rate Swaps | Interest Rate Swaps | Hedged Items |
| **Assets** | | | |
| Beginning balance, January 1, 2016 | **$ 106,695,082** | **$ 15,727,245** | **$ (51,606,468)** |
| Total realized and unrealized gains (losses): | | | |
| Included in earnings (expenses) | **100,699,195** | **(11,661,479)** | **(100,247,983)** |
| Included in other comprehensive income | **20,324,726** | **–** | **–** |
| Purchases | **–** | **–** | **–** |
| Settlements | **–** | **–** | **–** |
| Transfers in/out of Level 3 | **–** | **–** | **–** |
| Ending balance, December 31, 2016 | **$ 227,719,003** | **$ 4,065,766** | **$ (151,854,451)** |
| | | | |
| Beginning balance, January 1, 2015 | $ 36,938,315 | $ 18,433,614 | $ 1,698,406 |
| Total realized and unrealized gains (losses): | | | |
| Included in earnings (expenses) | 53,303,097 | (2,266,369) | (53,304,874) |
| Included in other comprehensive income (loss) | 19,117,644 | – | – |
| Purchases | – | – | – |
| Settlements | (2,663,974) | (440,000) | – |
| Transfers in/out of Level 3 | – | – | – |
| Ending balance, December 31, 2015 | $ 106,695,082 | $ 15,727,245 | $ (51,606,468) |
| | | | |
| **Liabilities** | | | |
| Beginning balance, January 1, 2016 | **$ 2,395,365** | **$ 3,815,603** | **$ 10,180,086** |
| Total realized and unrealized (gains) losses: | | | |
| Included in (earnings) expenses | **(2,395,365)** | **(3,815,603)** | **(7,248,538)** |
| Included in other comprehensive (income) loss | **–** | **–** | **–** |
| Purchases | **–** | **–** | **–** |
| Settlements | **–** | **–** | **–** |
| Transfers in/out of Level 3 | **–** | **–** | **–** |
| Ending balance, December 31, 2016 | **$ –** | **$ –** | **$ 2,931,548** |
| | | | |
| Beginning balance, January 1, 2015 | $ – | $ 20,426,135 | $ 5,047,280 |
| Total realized and unrealized (gains) losses: | | | |
| Included in (earnings) expenses | 2,395,365 | (16,610,532) | 5,132,806 |
| Included in other comprehensive (income) loss | – | – | – |
| Purchases | – | – | – |
| Settlements | – | – | – |
| Transfers in/out of Level 3 | – | – | – |
| Ending balance, December 31, 2015 | $ 2,395,365 | $ 3,815,603 | $ 10,180,086 |

## 11. Fair Value of Financial Instruments (continued)

The Bank entered into (9) nine cross-currency interest rate swaps and no interest rate swaps during the year ended December 31, 2016. Upon issuance, the fair value of the swaps is $0 and, therefore, is not portrayed in the purchases line item in the preceding table. The change in fair value of these instruments is included within the total gains (losses) line item.

The Bank has no nonfinancial assets or liabilities measured at fair value on a recurring basis. Certain nonfinancial assets and liabilities measured at fair value on a nonrecurring basis include foreclosed assets (upon initial recognition or subsequent impairment) and other nonfinancial long-lived assets measured at fair value for impairment assessment. The fair value of the collateral from foreclosed loans is measured using Level 3 unobservable inputs and is reported in other assets as other real estate owned of $2,978,307 and $4,786,389 at December 31, 2016 and 2015, respectively. For the years ended December 31, 2016 and 2015, the Bank recorded an impairment of $1,106,240 and $950,000, respectively, on the other real estate owned. The impairment is recorded as a non-interest expense in the consolidated statement of income.

## 12. Derivative Financial Instruments

The Bank utilizes cross-currency interest rate swaps to mitigate exposure to fluctuations in foreign currency exchange rates and interest rate swaps to mitigate exposure to fluctuations in interest rates. The fair value of the swaps outstanding as of each reporting period end is included in other assets or other liabilities, depending on whether the Bank is in a favorable or unfavorable position as of the reporting period date.

The Bank enters into cross-currency interest rate swaps that are matched to specific fixed, variable, or adjustable rate loans denominated in Mexican pesos that the Bank has entered into directly with the borrower or with COFIDAN. In the latter case, COFIDAN then enters into loans denominated in Mexican pesos under the exact same terms with its borrowers. The Bank has also entered into a cross-currency interest rate swap for a portion of its long-term notes payable issued in Swiss francs. These swaps have been designated as hedging instruments because they hedge the risk of fluctuations in cash flows due to changes in foreign currency exchange rates. The swaps are structured so that the notional amounts mature to match the expected maturity of the loans and the notes payable.

The Bank enters into interest rate swaps that are matched to the terms of loans and to a portion of its long-term notes payable. The swaps have been designated as hedging instruments, because they hedge the risk of changes in the fair value of fixed-rate loans and notes payable due to changes in

## 12. Derivative Financial Instruments (continued)

the designated benchmark interest rate. The Bank designated the LIBOR swap rate as the benchmark interest rate. The swaps are structured so that the notional amounts mature to match the expected maturity of the loans and the notes payable.

Under its arrangement with FOAEM, neither the Bank nor the counterparty is required to post collateral to support the outstanding fair value of the swaps. Beginning in July 2009, under counterparty relationships with other financial institutions, collateral may be required to be posted by either the Bank or the counterparty. Cash collateral of $135,490,000 and $67,600,000 was posted from counterparties to the Bank as of December 31, 2016 and December 31, 2015, respectively. No collateral was posted by the Bank as of December 31, 2016 and 2015.

The notional amounts and estimated fair values of the swaps outstanding at December 31, 2016 and 2015 are presented in the following table. The fair value of these swaps is estimated using internal valuation models with observable market data inputs.

| | **December 31, 2016** | | **December 31, 2015** | |
|---|---|---|---|---|
| | **Notional Amount** | **Estimated Fair Value, Net** | **Notional Amount** | **Estimated Fair Value, Net** |
| Cross-currency interest rate swaps | **$ 655,539,583** | **$ 227,719,003** | $ 645,173,665 | $ 104,299,717 |
| Interest rate swaps | **1,326,246,801** | **4,065,766** | 1,418,452,744 | 11,911,642 |

The referenced exchange rate received for the cross-currency interest rate swaps outstanding at December 31, 2016 and 2015 was 4.82% and 5.81%, respectively.

Swaps that are no longer deemed effective because of borrower default on the hedged loans are not included in the preceding table. There were no swaps that were considered ineffective due to borrower default as of December 31, 2016 and 2015.

### Gains and Losses on Derivative Cash Flows

<u>Cross-currency Interest Rate Swaps</u> – The effective portion of the gain or loss due to changes in the fair value of cross-currency interest rate swaps designated as cash flow hedges is included in the accompanying consolidated statements of comprehensive income, while the ineffective portion is included in income (expense) from net hedging activities. The accumulated gain (loss) is reclassified into earnings as the hedged cash flows are received to offset the foreign currency gains (losses) that would have been recognized in earnings if the Bank had not been a party to the swaps.

**12. Derivative Financial Instruments (continued)**

The accumulated net gain (loss) related to the swaps included in accumulated other comprehensive income totaled $16,141,732 and $7,397,213 at December 31, 2016 and 2015, respectively.

Gains or losses due to changes in the fair value of cross-currency interest rate swaps designated as fair value hedges and ineffective swaps are reported in income (expense) from net hedging activities. For the years ended December 31, 2016 and 2015, changes in the aforementioned swaps included in the accompanying consolidated statements of income were $1,447,745 and $2,974,496, respectively.

<u>*Interest Rate Swaps*</u> – With regard to the interest rate swaps on outstanding loans and a portion of the long-term notes payable, the changes in the fair value of the swaps offset the changes in the fair value of the loans and debt due to changes in the USD OIS curve, while the ineffective portion is included in income (expense) from net hedging activities. For the years ended December 31, 2016 and 2015, changes in the aforementioned swaps included in the accompanying consolidated statements of income were $394,266 and $1,115,092, respectively.

**13. Credit Risk Associated with Financial Instruments**

The Bank is subject to certain credit risk. Financial instruments that potentially subject the Bank to significant concentrations of credit risk consist principally of cash and cash equivalents, investments, loans receivable, and swaps. The Bank maintains cash and cash equivalents, investments, and certain other financial instruments with various major financial institutions. The Bank performs periodic evaluations of the relative credit standing of these financial institutions and limits the amount of credit exposure with any one institution. The Bank evaluates the creditworthiness of each customer on a case-by-case basis and continually monitors the financial stability of each borrower.

**14. Commitments**

In the normal course of business, the Bank has various outstanding commitments, in addition to the loans receivable disclosed in Note 4 and the long-term borrowings disclosed in Note 6. Under agreements with consultants and contractors in effect at December 31, 2016, the Bank has obligations to make payments contingent upon the future performance of the consultants and contractors under the terms of their respective contracts and, therefore, they are not recorded in the financial statements.

**14. Commitments (continued)**

**Lease Commitments**

The Bank rents office space under an operating lease that expires on February 28, 2026. Rent expense totaled $102,563 and $12,381 for the years ended December 31, 2016 and 2015, respectively. The following schedule summarizes the minimum future expenses for the forgoing lease.

| Year Ended December 31, | | |
|---|---|---|
| 2017 | $ | 204,797 |
| 2018 | | 211,792 |
| 2019 | | 214,231 |
| 2020 | | 221,831 |
| 2021 | | 223,064 |
| Thereafter | | 994,494 |
| | $ | 2,070,209 |

**15. Accounting Standards Updates**

Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective for the Bank on January 1, 2019. The Bank does not anticipate a significant impact to its consolidated financial statements since the primary source of revenue is interest income from loans and investments.

**15. Accounting Standards Updates (continued)**

ASU 2015-02, *Consolidation* (*Topic 810) – Amendments to the Consolidation Analysis*. ASU 2015-02 implements changes to both the variable interest consolidation model and the voting interest consolidation model. ASU 2015-02 (i) eliminates certain criteria that had to be met in determining when fees paid to a decision-maker or service provider do not represent a variable interest, (ii) amends the criteria for determining whether a limited partnership is a variable interest entity and (iii) eliminates the presumption that a general partner controls a limited partnership in the voting model. ASU 2015-02 will be effective for the Bank on January 1, 2017 and is not expected to have a significant impact on the Bank's consolidated financial statements.

ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. ASU 2016-1 will be effective for the Bank on January 1, 2019 and is not expected to have a significant impact on the Bank's consolidated financial statements.

ASU 2016-02, *Leases (Topic 842).* ASU 2016-02, among other things, require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and *ASC Topic 606: Revenue from Contracts with Customers.* ASU 2016-02 will be effective for the Bank on January 1, 2020 and will require transition using a modified retrospective approach

## 15. Accounting Standards Updates (continued)

for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Bank is evaluating the potential impact of ASU 2016- 02 to its consolidated financial statements and disclosures.

ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Bank on January 1, 2021. The Bank is evaluating the potential impact of ASU 2016-13 to its consolidated financial statements.

## 16. Other Significant Event

On December 3, 2014, the Board approved a resolution recommending the merger of NADB and BECC into a single institution. The proposed integration would preserve the current mission, purposes and functions of both organizations, including their environmental mandate and geographic jurisdiction. The integration is currently in process.

## 17. Subsequent Events

On March 10, 2017, the Bank issued 15-year notes in Norwegian krone in the amount of kr 1,445,000,000 ($173,448,566 USD), with a coupon rate of 2.47%, interest payments due annually on March 10, and first principal payment due on March 10, 2031.

The Bank has evaluated subsequent events for potential recognition and/or disclosure through March 31, 2017, the date these consolidated financial statements were issued.

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# Supplementary Information

# North American Development Bank

## Combining Balance Sheet by Program

### December 31, 2016

| | International Program | U.S. Domestic Program (A) | Eliminations | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents: | | | | |
| Held at other financial institutions in demand deposit accounts | $ 193,964 | $ – | $ – | $ 193,964 |
| Held at other financial institutions in interest-bearing accounts | 28,619,810 | 213,695 | – | 28,833,505 |
| Repurchase agreements | 122,400,000 | 300,000 | – | 122,700,000 |
| | 151,213,774 | 513,695 | – | 151,727,469 |
| Held-to-maturity investment securities, at amortized cost | 53,782,155 | – | – | 53,782,155 |
| Available-for-sale investment securities, at fair value | 306,562,226 | – | – | 306,562,226 |
| Loans outstanding | 1,411,295,846 | 329,827 | – | 1,411,625,673 |
| Allowance for loan losses | (25,052,471) | (23,188) | – | (25,075,659) |
| Unamortized loan fees | (10,682,210) | – | – | (10,682,210) |
| Foreign currency exchange rate adjustment | (55,027,169) | – | – | (55,027,169) |
| Hedged items, at fair value | (151,854,451) | – | – | (151,854,451) |
| Net loans outstanding | 1,168,679,545 | 306,639 | – | 1,168,986,184 |
| Interest receivable | 26,806,830 | 15 | – | 26,806,845 |
| Grant and other receivable | 7,320,234 | – | – | 7,320,234 |
| Due from U.S. Domestic Program | 9,997 | – | (9,997) | – |
| Furniture, equipment and leasehold improvements, net | 461,759 | – | – | 461,759 |
| Other assets | 98,029,324 | – | – | 98,029,324 |
| Total assets | $ 1,812,865,844 | $ 820,349 | $ (9,997) | $ 1,813,676,196 |
| **Liabilities and equity** | | | | |
| Liabilities: | | | | |
| Accounts payable | $ 7,454,439 | $ 1,648 | $ – | $ 7,456,087 |
| Accrued liabilities | 425,115 | 16,332 | – | 441,447 |
| Due to International Program | – | 9,997 | (9,997) | – |
| Accrued interest payable | 16,593,968 | – | – | 16,593,968 |
| Undisbursed grant funds | 6,328 | – | – | 6,328 |
| Short-term debt | 5,262,000 | – | – | 5,262,000 |
| Long-term debt, net of discount and unamortized debt issuance costs | 1,176,158,912 | – | – | 1,176,158,912 |
| Hedged items, at fair value | 2,931,548 | – | – | 2,931,548 |
| Net long-term debt | 1,179,090,460 | – | – | 1,179,090,460 |
| Total liabilities | 1,208,832,310 | 27,977 | (9,997) | 1,208,850,290 |
| Equity: | | | | |
| Paid-in capital | 415,000,000 | – | – | 415,000,000 |
| General Reserve: | | | | |
| Allocated paid-in capital | – | 2,460,790 | – | 2,460,790 |
| Retained earnings: | | | | |
| Designated | 13,458,447 | (1,678,313) | – | 11,780,134 |
| Reserved | 114,543,479 | 9,895 | – | 114,553,374 |
| Undesignated | 45,058,709 | – | – | 45,058,709 |
| Accumulated other comprehensive income | 15,967,278 | – | – | 15,967,278 |
| Non-controlling interest | 5,621 | – | – | 5,621 |
| Total equity | 604,033,534 | 792,372 | – | 604,825,906 |
| Total liabilities and equity | $ 1,812,865,844 | $ 820,349 | $ (9,997) | $ 1,813,676,196 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

# North American Development Bank
# Combining Statement of Income by Program

## Year Ended December 31, 2016

| | International Program | U.S. Domestic Program (A) | Total |
|---|---|---|---|
| Interest income: | | | |
| Loans | $ 52,426,637 | $ 3,378 | $ 52,430,015 |
| Investments | 6,584,903 | 1,783 | 6,586,686 |
| Total interest income | 59,011,540 | 5,161 | 59,016,701 |
| Interest expense | 19,950,461 | – | 19,950,461 |
| Net interest income | 39,061,079 | 5,161 | 39,066,240 |
| Operating expenses: | | | |
| Personnel | 8,282,656 | – | 8,282,656 |
| General and administrative | 1,467,292 | – | 1,467,292 |
| Consultants and contractors | 2,720,662 | – | 2,720,662 |
| Provision for loan losses | 5,133,737 | – | 5,133,737 |
| Other | 193,253 | | 193,253 |
| Depreciation | 136,461 | 692 | 137,153 |
| U.S. Domestic Program | – | 268,461 | 268,461 |
| Total operating expenses | 17,934,061 | 269,153 | 18,203,214 |
| Net operating income (loss) | 21,127,018 | (263,992) | 20,863,026 |
| Non-interest income and expenses: | | | |
| Gains on sales of available-for-sale securities | 137,177 | – | 137,177 |
| Other income (expense) from hedging activities, net | 1,101,921 | – | 1,101,921 |
| Other income (expense) from foreign exchange activities, net | (701,842) | – | (701,842) |
| Fees and other income | 200,000 | – | 200,000 |
| Loss on other real estate owned | (1,106,240) | – | (1,106,240) |
| Total non-interest income (expenses) | (368,984) | – | (368,984) |
| Income (loss) before program activities | 20,758,034 | (263,992) | 20,494,042 |
| Program activities: | | | |
| EPA grant income | 843,300 | – | 843,300 |
| EPA grant administration | (843,300) | – | (843,300) |
| TAP | (537,557) | – | (537,557) |
| CAP | (429,633) | – | (429,633) |
| WCIF | (120,808) | – | (120,808) |
| Net program expenses | (1,087,998) | – | (1,087,998) |
| Income (loss) before non-controlling interest | 19,670,036 | (263,992) | 19,406,044 |
| Net loss attributable to non-controlling interest | (142) | – | (142) |
| Net income (loss) | $ 19,670,178 | $ (263,992) | $ 19,406,186 |
| **General Reserve, January 1, 2016** | | | |
| Allocated paid-in capital | $ – | $ 3,027,256 | $ 3,027,256 |
| Retained earnings | 153,390,457 | (1,404,426) | 151,986,031 |
| Current period activity: | | | |
| Net income (loss) | 19,670,178 | (263,992) | 19,406,186 |
| TGP disbursements of the U.S. Domestic Program | – | (566,466) | (566,466) |
| **General Reserve, December 31, 2016** | | | |
| Allocated paid-in capital | – | 2,460,790 | 2,460,790 |
| Retained earnings | 173,060,635 | (1,668,418) | 171,392,217 |
| | $ 173,060,635 | $ 792,372 | $ 173,853,007 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

# North American Development Bank

## Combining Statement of Comprehensive Income by Program

Year Ended December 31, 2016

| | International Program | U.S. Domestic Program (A) | Total |
|---|---|---|---|
| Income (loss) before non-controlling interest | $ 19,670,036 | $ (263,992) | $ 19,406,044 |
| Net loss attributable to non-controlling interest | (142) | – | (142) |
| Net income (loss) | 19,670,178 | (263,992) | 19,406,186 |
| Other comprehensive income (loss): | | | |
| Available-for-sale investment securities: | | | |
| Change in unrealized gain during the period, net | 15,481 | – | 15,481 |
| Reclassification adjustment for net gain included in net income | (137,177) | – | (137,177) |
| Total unrealized loss on available-for-sale investment securities | (121,696) | – | (121,696) |
| Foreign currency translation adjustment | 158,889 | – | 158,889 |
| Unrealized gains (losses) on hedging activities: | | | |
| Foreign currency translation adjustment, net | (11,580,208) | – | (11,580,208) |
| Fair value of cross-currency interest rate swaps, net | 20,324,726 | – | 20,324,726 |
| Total unrealized gain on hedging activities | 8,744,518 | – | 8,744,518 |
| Total other comprehensive income | 8,781,711 | – | 8,781,711 |
| Total comprehensive income (loss) | $ 28,451,889 | $ (263,992) | $ 28,187,897 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

# North American Development Bank

## Combining Statement of Cash Flows by Program

### Year Ended December 31, 2016

| | International Program | U.S. Domestic Program (A) | Total |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) | $ 19,670,178 | $ (263,992) | $ 19,406,186 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation | 136,461 | 692 | 137,153 |
| Amortization of net premium (discount) on investments | 907,746 | – | 907,746 |
| Change in fair value of swaps, hedged items and other non-cash items | 68,912,405 | – | 68,912,405 |
| Non-controlling interest | (142) | – | (142) |
| Gain on sales of available-for-sale investment securities, net | (137,177) | – | (137,177) |
| Provision for loan losses | 5,133,737 | – | 5,133,737 |
| Change in other assets and liabilities: | | | |
| (Increase) decrease in interest receivable | (15,582,102) | 1,817 | (15,580,285) |
| Increase in receivable and other assets | (4,813,027) | – | (4,813,027) |
| Decrease in due from U.S. Domestic Program and decrease due to International Program | 15,877 | (15,877) | – |
| Increase in accounts payable | 5,641,355 | 1,648 | 5,643,003 |
| Increase in accrued liabilities | 91,277 | 150 | 91,427 |
| Increase in accrued interest payable | 7,514,503 | – | 7,514,503 |
| Net cash provided by (used in) operating activities | 87,491,091 | (275,562) | 87,215,529 |
| **Lending, investing, and development activities** | | | |
| Capital expenditures | (342,452) | – | (342,452) |
| Loan principal repayments | 49,733,954 | 28,574 | 49,762,528 |
| Loan disbursements | (136,252,752) | – | (136,252,752) |
| Purchase of held-to-maturity investments | (2,261,000) | – | (2,261,000) |
| Purchase of available-for-sale investments | (240,224,271) | – | (240,224,271) |
| Proceeds from maturities of held-to-maturity investments | 2,235,000 | – | 2,235,000 |
| Proceeds from sales and maturities of available-for-sale investments | 270,221,619 | – | 270,221,619 |
| Net cash provided by (used in) lending, investing, and development activities | (56,889,902) | 28,574 | (56,861,328) |
| **Financing activities** | | | |
| Capital contribution | 10,000,000 | – | 10,000,000 |
| Proceeds from other borrowings | 2,216,528 | – | 2,216,528 |
| Principal repayment of other borrowings | (5,262,000) | – | (5,262,000) |
| Grant funds –- EPA | 10,650,006 | – | 10,650,006 |
| Grant disbursements – EPA | (10,644,678) | – | (10,644,678) |
| Grant activity – U.S. Domestic Program | – | (566,466) | (566,466) |
| Net cash provided by (used in) financing activities | 6,959,856 | (566,466) | 6,393,390 |
| Net increase (decrease) in cash and cash equivalents | 37,561,045 | (813,454) | 36,747,591 |
| Cash and cash equivalents at January 1, 2016 | 113,652,729 | 1,327,149 | 114,979,878 |
| Cash and cash equivalents at December 31, 2016 | $ 151,213,774 | $ 513,695 | $ 151,727,469 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

North American Development Bank

Border Environment Infrastructure Fund (BEIF)

As of and for the Year Ended December 31, 2016

**Balance Sheet**

| | Region 6 | Region 9 | Total |
|---|---|---|---|
| **Assets** | | | |
| Cash | $ 3,445 | $ 2,883 | $ 6,328 |
| Total assets | $ 3,445 | $ 2,883 | $ 6,328 |
| **Liabilities** | | | |
| Undisbursed grant funds | $ 3,445 | $ 2,883 | $ 6,328 |
| Total liabilities | $ 3,445 | $ 2,883 | $ 6,328 |

**Statement of Income**

| | Region 6 | Region 9 | Total |
|---|---|---|---|
| Income: | | | |
| U.S. Environmental Protection Agency grant income | $ 297,624 | $ 545,676 | $ 843,300 |
| Total income | 297,624 | 545,676 | 843,300 |
| BEIF operating expenses: | | | |
| Personnel | 155,914 | 155,914 | 311,828 |
| Consultants | 103,451 | 370,796 | 474,247 |
| General and administrative | 27,857 | 5,054 | 32,911 |
| Operational travel | 10,402 | 13,912 | 24,314 |
| Total BEIF operating expenses | 297,624 | 545,676 | 843,300 |
| Net income | $ – | $ – | $ – |

**Statement of Cash Flows**

| | Region 6 | Region 9 | Total |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | $ – | $ – | $ – |
| Net cash provided by operating activities | – | – | – |
| **Financing activities** | | | |
| Grant funds – EPA | 2,934,485 | 7,715,521 | 10,650,006 |
| Grant disbursements – EPA | (2,931,540) | (7,713,138) | (10,644,678) |
| Net cash provided by financing activities | 2,945 | 2,383 | 5,328 |
| Net increase in cash and cash equivalents | 2,945 | 2,383 | 5,328 |
| Cash and cash equivalents at January 1, 2016 | 500 | 500 | 1,000 |
| Cash and cash equivalents at December 31, 2016 | $ 3,445 | $ 2,883 | $ 6,328 |

*Region 6: EPA Regional Office located in Dallas, Texas*
*Region 9: EPA Regional Office located in San Francisco, California*

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North American Development Bank