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CREDIT OPINION
27 June 2023

Update

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RATINGS

NADB

	Rating	Outlook
Long-term Issuer	Aa1	Stable
Short-term Issuer	P-1	--

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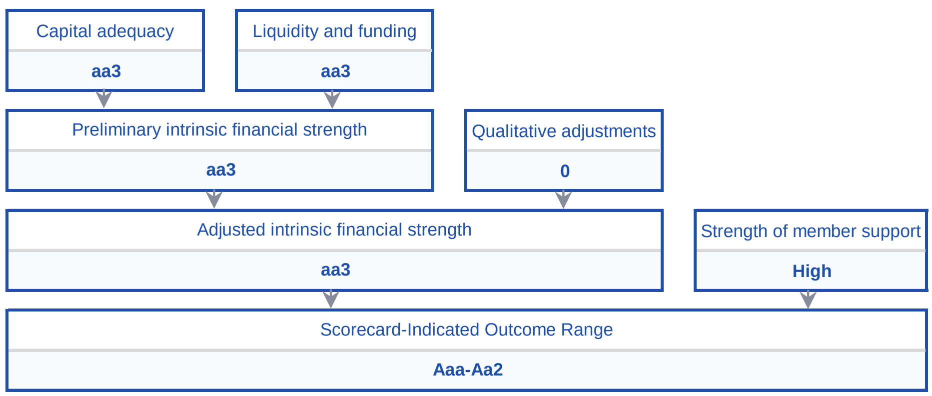
North American Development Bank – Aa1 stable

Regular update

Summary

The North American Development Bank's (NADB) credit profile reflects the bank's high capital adequacy and liquidity position, and strong support from the US (Aaa stable) and Mexico (Baa2 stable), its two shareholder members. These strengths are offset by a narrow geographic mandate that contributes to a relatively concentrated loan portfolio and to member concentration risks. The bank's capital and liquidity ratios remain strong.

Exhibit 1
NADB's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

» Low leverage compared with that of peers

» Very strong liquidity policy and coverage of debt service

» High member support, underpinned by capital increase

Credit challenges

» High loan portfolio concentration by country given a narrow geographic mandate

» Portfolio remains concentrated despite reduced focus on renewable energy

» Member concentration risks given shareholder base of two governments

Rating outlook

The stable outlook reflects our expectation that moderate loan growth and the ongoing capital increase will support NADB's robust capital adequacy while its liquidity coverage will also remain strong. Risks to NADB's asset quality and performance reduced significantly after the resolution of Mexico's proposed changes to the regulatory framework of the electricity sector, which will no longer affect significantly the bank's clean energy loans in the country.

Factors that could lead to an upgrade

An upward reassessment of the rating could occur from a significant and sustained improvement in the average borrower credit quality of the bank's loan portfolio and a significant reduction in concentration risks of the portfolio or a mitigation of these risks through significantly larger capital buffers and lower leverage.

Factors that could lead to a downgrade

NADB's credit profile could come under negative pressure if there is a substantial deterioration in asset quality or if there is a deterioration in the strength of member support, either through a significantly lower weighted average shareholder rating or if there is evidence of a shift in willingness to support the institution by any of its members.

Key indicators

Exhibit 2

North American Development Bank (NADB)	2017	2018	2019	2020	2021	2022
Total Assets (USD million)	2,146.3	1,959.1	2,007.5	2,177.2	2,114.6	1,985.3
Development-related Assets (DRA) / Usable Equity [1]	203.8	196.7	190.6	147.5	125.7	122.9
Non-Performing Assets / DRA	1.1	0.0	0.0	0.0	0.0	0.0
Return on Average Assets	1.5	1.0	1.5	0.7	0.6	0.0
Liquid Assets / ST Debt + CMLTD	313	15,186	295	19,150	728	21,090
Liquid Assets / Total Assets	44.5	40.8	37.5	46.3	53.4	55.9
Callable Capital / Gross Debt	344.2	399.4	392.2	419.6	440.9	498.3

[1] Usable equity is total shareholder's equity and excludes callable capital

Source: Moody's Investors Service

Profile

Headquartered in San Antonio, Texas, the North American Development Bank (NADB) was established in 1994 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 (BECC) and a North American Development Bank. The BECC has since been merged with NADB, which carries out studies in-house. In March 1994, the President of the US issued an Executive Order designating the bank as an international organization under the International Organization Immunities Act.

The bank's main activity is its International Program, through which it provides loans, grants, and technical assistance and training to border municipalities and private-sector companies in both Mexico and the US; most of the loans are extended in Mexico to the private sector, mostly in the renewable energy sector. To facilitate lending to Mexican borrowers in the public sector, the bank has one subsidiary, of which it owns 99.90%, Corporacion Financiera de America del Norte (COFIDAN). The Mexican government owns the remaining 0.10% of COFIDAN. NADB faces a high degree of geographic concentration risk because it only operates in two countries, with an additional forced concentration to within a 400 kilometer north-south band.[1]

Detailed credit considerations

Our determination of a supranational's rating is based on three rating factors: capital adequacy, liquidity and funding, and strength of member support. For multilateral development banks (MDBs), the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors can affect the intrinsic financial strength, such as risks stemming from the operating environment or the quality of management. The strength of member support is then incorporated to yield a rating range. For more information, please see our Supranational Rating Methodology.

FACTOR 1: Capital adequacy score: aa3

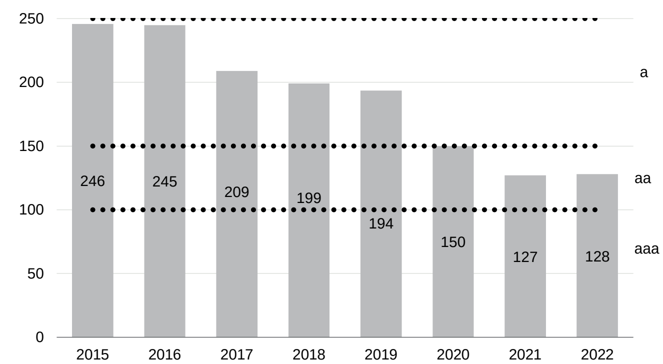
NADB's "aa3" capital adequacy assessment balances low leverage relative to similar peers, strong asset performance and moderate asset quality against high concentration risk by country and sector. We expect leverage in the medium term to remain comparatively low as a result of the bank's cautious loan growth plans and incoming paid-in capital contributions.

Prepayments and capital contributions keep leverage low

Reserve accumulation, moderate loan growth and a consistent history of prepayments have led to a steady decrease in NADB's leverage following a sustained expansion of its loan portfolio in 2012-16 (see Exhibit 3). In 2022, NADB's leverage ratio (development-related assets/equity) was 128%, with a three-year average of 135% that scored "aa3." Compared with other Aa-rated peers, NADB has one of the lowest leverage ratios (see Exhibit 4). We expect incoming paid-in capital contributions and the bank's prudent plans for loan portfolio growth to continue over the coming years, keeping leverage low.

Exhibit 3

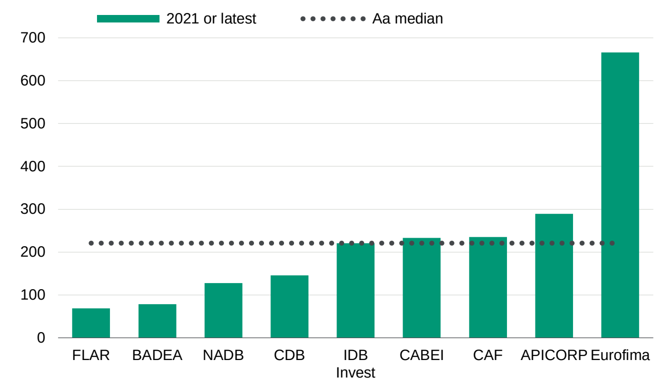
NADB's leverage ratio has stabilized following a multiyear decline
(DRA/equity as %; dotted lines show scoring ranges for capital position)



Sources: NADB and Moody's Investors Service

Exhibit 4

NADB's leverage is among the lowest in the Aa rating category
(DRA/equity as %)



Source: Moody's Investors Service

The ongoing increase in paid-in capital, which will continue through 2028, is also limiting leverage. In 2016, the governments of the US and Mexico agreed on a general capital increase of $3 billion for the bank, which doubled the subscribed capital to $6 billion. However, disbursements for paid-in capital, which would affect our measure of leverage, were not forthcoming. In April 2020, Mexico and the US agreed on a paid-in capital disbursement schedule that will see paid-in capital increase from $415 million in December 2019 to $855 million by year-end 2028. This will steadily raise NADB's usable equity throughout the next decade. As of year-end 2022, paid-in capital had reached $496 million.

Asset quality is moderate, balancing medium credit quality and mandate-driven portfolio concentration

We assess NADB's development assets' credit quality as "baa." Our assessment incorporates the weighted average borrower rating of NADB's loan book, which was Ba2 as of year-end 2022, down from Baa3 in 2021. The shift reflects partly a change in NADB's risk assessment methodology that did not significantly alter the default probability of its loans but contributed to a dispersion on the mapping to Moody's rating scale (see Exhibit 5).

Relative to all other MDBs that we rate, NADB faces the highest degree of geographic concentration risk because it only operates in the area around the Mexico-US border — as of year-end 2022, 69% of loans were in Mexico (see Exhibit 6). Over the past decade, NADB focused on increasing loans to clean energy projects, which contributed to an increase in sector concentration given their larger size (see Exhibit 7).

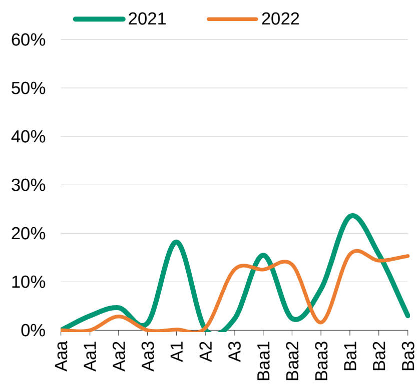
Moreover, given the high degree of sector and geographic concentration, the risk of regulatory changes in Mexico's energy sector was a key credit risk for NADB as clean energy projects in Mexico make up over a third of NADB's loan portfolio. The rejection of a constitutional energy reform by the Mexican Congress in 2022 and continued litigation affecting the implementation of the 2021 electricity industry law have reduced risks related to the regulatory environment and operations of NADB's projects.

The high degree of loan concentration has reduced considerably, with the 10 largest loans extended by NADB accounting for 54.3% of its portfolio as of year-end 2022, down from 79% in 2012. As the bank continues to expand its operations, the share of top 10 exposures from the total lending portfolio is unlikely to rise significantly.

Exhibit 5

NADB's credit quality became more dispersed in 2022

(Loan portfolio by rating, % of total)

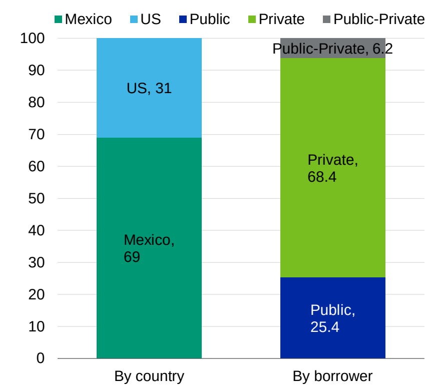


Sources: NADB and Moody's Investors Service

Exhibit 6

Portfolio is concentrated in Mexico and the private sector

(Loan portfolio by country and borrower in 2022, % of total)

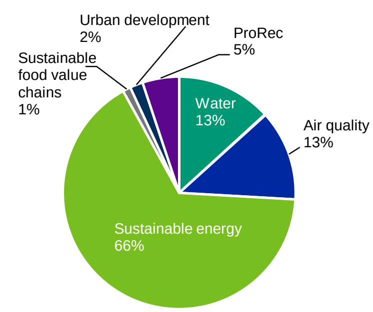


Sources: NADB and Moody's Investors Service

Exhibit 7

Portfolio is concentrated in sustainable energy

(Loan portfolio by sector in 2022, % of total)



ProRec is the COVID-19 Recovery Program.
Sources: NADB and Moody's Investors Service

Asset performance remains very strong

As of year-end 2022, NADB did not register any nonperforming assets, in accordance with our definition,[2] scoring "aaa" for asset performance. Provisions as a percentage of gross loans were 2.4% as of year-end 2022, up from 1.7% in 2020 and in line with 2.3% in 2021. The bank's adoption of a new credit risk methodology contributed to the higher provisioning. We expect moderate loan growth and prudent risk management to keep nonperforming loans as a percentage of gross loans low.

FACTOR 2: Liquidity and funding score: aa3

Our “aa3” liquidity and funding score for NADB reflects its strong liquidity position, one of its key strengths. Limited debt issuance and loan disbursements, coupled with prepayments, have led to the accumulation of a substantial liquidity buffer.

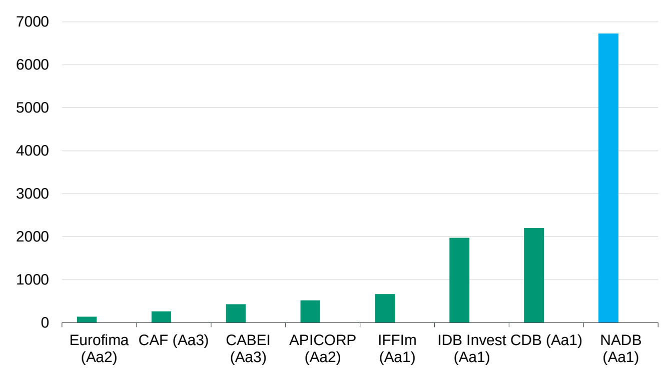
Liquidity coverage is very strong because of low borrowing needs

NADB’s liquidity policy requires that “the minimum amount of aggregate liquid asset holdings is equal to the highest consecutive 12 months of the following 18 months of expected debt-service obligations, plus committed net loan disbursements (if positive), plus projected operating expenses for the relevant fiscal year.” The bank determines a minimum amount before the beginning of the fiscal year and can revise it during the year to account for major changes in the outlook.

The upshot of NADB’s liquidity policy is that the bank compares favorably with most Aa-rated peers in terms of liquidity indicators. Most years, NADB's availability of liquid resources ratio (net cash and liquid assets as a percentage of outflows expected over the next 18 months in a stress scenario without new market issuances or capital contributions from members) is one of the highest among the MDBs that we rate (see Exhibit 8) — scoring “aaa.” Its liquid assets relative to maturing debt also rank among the strongest in its peer group. This is a reflection of NADB's low leverage and well-spread maturity profile (see Exhibit 9), and its moderate growth plans, which contribute to keep its borrowing needs low.

Exhibit 8

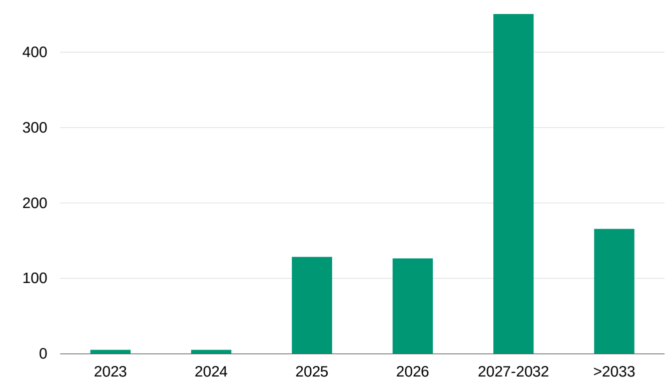
NADB has strong liquidity coverage
(Liquid assets/short term + currently maturing long-term debt, three-year average, latest in %)



Sources: NADB and Moody’s Investors Service

Exhibit 9

Amortization profile is spaced out, reducing rollover risk
($ million)



Sources: NADB and Moody’s Investors Service

Another factor supporting the long-term strength of the bank’s liquidity position is that one of its reserve funds (part of retained earnings) is a debt-service reserve fund. It ranks first in the order of priority for funding of any of the bank’s reserve funds and is maintained in an amount equal to 12 months of interest due on the bank’s outstanding debt at each fiscal year-end. The existence of this fund effectively puts aside a portion of total liquid assets for debt service, therefore complementing the liquidity policy and providing additional protection to bondholders.

Funding program is still limited

NADB’s quality of funding indicator scores “a,” below the “aa” score that we assign to most of its Aa-rated peers given their longer established track record in issuing debt. However, the bank has updated its green bond framework — this was established in 2018 and last updated in 2020 — and will continue to issue green bonds, and it is also studying different issuance options that would facilitate opportunistic issuances.

NADB’s low leverage and small size have led to a modest borrowing program. NADB currently has eight bonds outstanding, issued in three currencies (US dollar, Swiss franc and Norwegian krone). NADB has also started borrowing in Mexican pesos, which will enable it to continue to diversify its investor base while also increasing efficiencies in currency management between its assets and liabilities.

Qualitative adjustments to intrinsic financial strength

Operating environment

We have not applied qualitative adjustments in our assessment of NADB's credit profile. The aforementioned risks related to an uncertain regulatory environment in the Mexican electricity sector have been reduced following the Mexican Congress' rejection of constitutional reforms that would have detrimental effects on Mexico's private energy producers and NADB's portfolio quality. Although we expect shareholder countries to face macroeconomic challenges in the near term, in view of high consumer prices and more moderate economic growth, we do not expect these factors to weigh significantly on NADB's credit metrics beyond what is already captured by the intrinsic financial strength ratios.

Quality of management

NADB's quality of management is in line with the practices at the MDBs that we rate. In addition to having robust capital adequacy and liquidity risk policies, NADB's management has ensured compliance with these policies, which in turn has resulted in strong credit metrics. NADB has also made efforts to continue to enhance its risk management capabilities. For example, in 2017, its internal risk department developed and implemented 13 methodologies to assess the credit risk of its loan portfolio based on a review of the bank's historical credit rating standards, Basel II IRB approaches, credit rating agencies' methodologies, industry best practices and current regulatory aspects.

FACTOR 3: Strength of member support score: High

NADB's score of "High" for strength of member support reflects its shareholders' contractual commitment and ability to provide support in a stress scenario. These strengths are, however, offset by some policy decisions made by shareholders, namely Mexico's proposed energy sector reform proposal that since been discarded, that weighed on the assessment of non-contractual support, and the fact that the US is an anchor shareholder in numerous other MDBs.

Despite recent weakening, members still have strong ability and willingness to support the bank

The composition of the board of directors, which includes minister level officials from both federal governments, including the treasury secretaries, coupled with the organization's visible progress in fulfilling its mandate, suggests strong willingness to support the institution. The presence of domestic programs, with NADB being the only MDB to lend in the US, and the high visibility conveyed by the unique bilateral nature of the organization also suggest strong willingness to support.

In 2016, the board of directors of NADB and the governments of Mexico and the US agreed to increase subscribed capital to $6 billion from $3 billion, with both countries subscribing in equal amounts. This capital increase process experienced delays and in 2020, following the ratification of the United States-Mexico-Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA), the shareholders agreed on a new payment schedule of the paid-in capital, with payments now scheduled to be completed by yearend 2028. The finalized paid-in capital disbursement schedule will see paid-in capital increase to $855 million by year-end 2028 from $415 million in December 2019. The US disbursed all of its scheduled payments ahead of time, but most of the funds are deemed restricted from commitment and will be released over time, in accordance with the agreement between the shareholders. As of December 2022, the US' paid-in capital stood at $263 million. The remainder will be progressively recognized as paid-in capital in the balance sheet following the agreed schedule. As of December 2022, Mexico's paid-in capital was $234 million, bringing total paid-in capital to $496 million. The expected capital contributions will bolster the bank's capital position and provide a buffer against asset quality pressures.

Considering the reduced level of risk related to regulatory changes in Mexico's energy sector, we consider non-contractual support to be "High." Our assessment also reflects the agreement regarding paid-in capital contributions, which underscores the shareholders' continued support and the role of the US as a key shareholder.

The credit strengths of NADB's shareholders underpin our member support score. With a weighted average shareholder rating of "a2," the bank has one of the strongest shareholder bases compared with regional MDBs in the Americas, and compares favorably with most of the regional MDBs outside of Europe. In view of the institution's very small size relative to the combined federal budgets of the two member countries, the costs of a recapitalization in an adverse scenario would likely prove negligible.

Binational mandate leads to member concentration risks

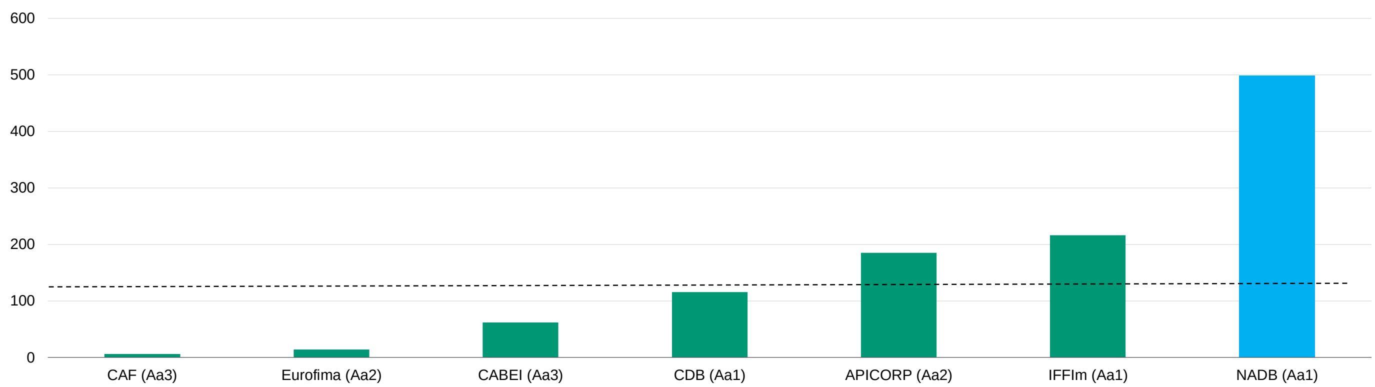
Another weakness from the member support perspective is the fact that the organization's shareholder base is inherently highly concentrated. Equally split between its two members, NADB's ownership structure is the least diversified among MDBs that we rate. The issue of high member concentration is further exacerbated by the close economic links between the two countries. The US accounts for around 80% of Mexico's total exports and most of the stock of foreign direct investment in Mexico, solidifying its position as the largest foreign investor in the country. Given the strong economic links, any episode of widespread economic distress in the US would be followed immediately by economic distress in Mexico, thus diminishing the benefits of shareholder diversification enjoyed by some other MDBs.

Callable capital continues to provide sizable protection to bondholders

The bank continues to benefit from substantial callable capital, which forms the basis of our contractual support assessment, for which NADB scores "aaa." Our assessment takes the callable capital from both shareholders (Mexico and the US) and compares it with NADB's total debt stock. NADB's low leverage, coupled with the doubling of callable capital in 2016, means that the bank's capital coverage is the second highest among Aa-rated MDBs (see Exhibit 10). Assuming that the shareholders do not amend or rescind their capital pledges in an adverse scenario, callable capital commitments offer sufficient absorption capacity to insulate bondholders from any possible credit losses even if the debt burden were to more than triple from its current levels.

Exhibit 10

NADB's callable capital as a percentage of debt is one the highest among Aa-rated MDBs
(Callable capital as a percentage of gross debt, and dotted line shows the Aa-rated median, latest in %)

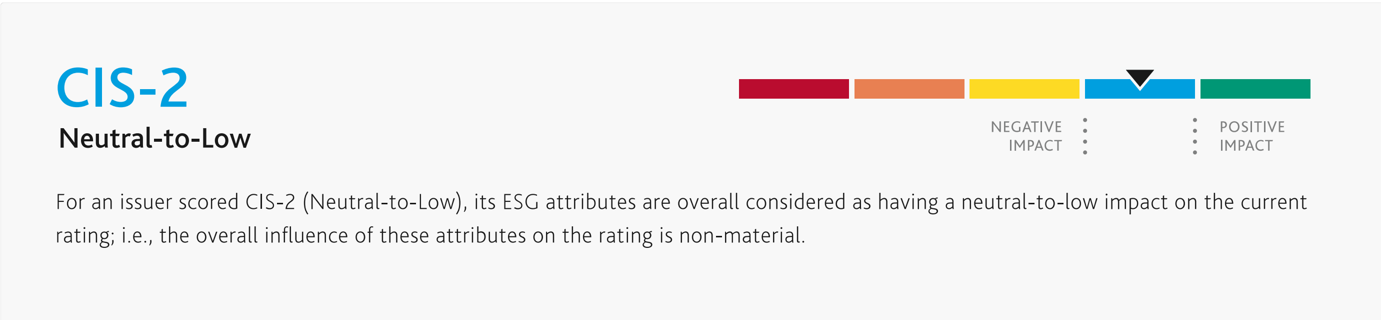


Data are from 2021 for CABEI, CDB, Eurofima and IFFIM.
Source: Moody's Investors Service

ESG considerations

North American Development Bank's ESG Credit Impact Score is Neutral-to-Low CIS-2

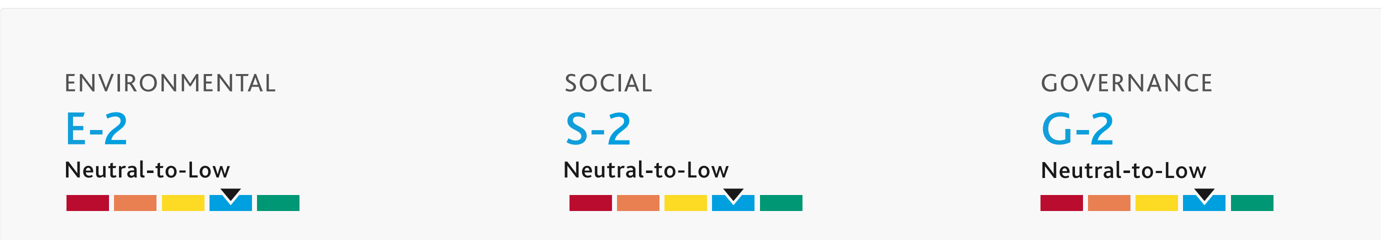
Exhibit 11
ESG Credit Impact Score



Source: Moody's Investors Service

NADB's **CIS-2** credit impact score reflects low exposures to environmental, social and governance risks on its credit profile. Although potential changes in energy regulations in Mexico exposed NADB risks to its asset quality and performance, the bank's focus on renewable energy will remain key for its development mandate. The effective execution of this mandate also supports NADB's social impact in its region of operations and highlights its robust governance.

Exhibit 12
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

NADB's environmental issuer profile score is **E-2**. Although NADB is exposed to carbon transition risks particularly in Mexico given the government's prioritization of the national utility company that depends more on hydrocarbons for electricity generation, the bank has a clear mandate on clean energy. Additionally, NADB focuses on improving water management and air quality in its region of operations, with the overall goal of mitigating environmental risks along the Mexico-US border region.

Social

NADB has a **S-2** social issuer profile score, in line with the broader sector. This assessment reflects Moody's views of NADB's strong customer relations and responsible production, which allow it to have important socioeconomic impact in its region of operations along the US-Mexico border region.

Governance

NADB's governance issuer profile score is **G-2**, given its prudent risk management practices that help mitigate risks from its lending operations to sub-national governments and private sector entities. This balances moderately negative risk to the issuer profile from concentrated ownership with only two shareholders, namely the US and Mexico, that can at times foster cooperation but is also susceptible to political developments in both countries.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Recent developments

Loan disbursements slowed down in 2022 but were strong in the first quarter of 2023

The first quarter data from 2023 shows favorable loan growth at 4% relative to year-end 2022. In 2022, gross loan disbursements totaled $90 million, down from $117.2 million in 2021 yet significantly larger than the $51.2 million in 2020. Principal amortizations were $72.5 million in 2022 compared with $82.5 million in 2021. In addition to the amortizations, NADB continued to see loan prepayments in 2022 ($73.8 million, compared with $184.5 million in 2021), which led to a decrease in loans outstanding to $920.3 million in 2022 from $976.5 in 2021. In some instances, these prepayments reflect the merger or acquisition of the projects financed by NADB, which are then refinanced by the new sponsor entity. This reflects the key role played by NADB in supporting the initial phase of some projects that typically would not draw private investors until they are deemed to be financially attractive. However, the high interest rate environment led to less prepayments in 2022 because the high rates create less incentives for borrowers to refinance loans.

In 2022, NADB started its peso treasury with its first financing in Mexican pesos. The loan, equivalent of $100 million, has a five-year maturity. The net proceeds from this transaction will be allocated to the financing of green projects in line with the bank's Green Bond Framework.

Rating methodology and scorecard factors: NADB - Aa1 stable

Factor / Subfactor	Metric	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)			aa3	aa3
Capital position (20%)			aa3	
	Leverage ratio	aa3		
	Trend	0		
	Impact of profit and loss on leverage	0		
Development asset credit quality (10%)			baa	
	DACQ assessment	baa		
	Trend	0		
Asset performance (20%)			aaa	
	Non-performing assets	aaa		
	Trend	0		
	Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)			aa3	aa3
Liquid resources (15%)			aaa	
	Availability of liquid resources	aaa		
	Trend in coverage outflow	0		
	Access to extraordinary liquidity	0		
Quality of funding (35%)			a	
Preliminary intrinsic financial strength				aa3
Other adjustments				0
Operating environment		0		
Quality of management		0		
Adjusted intrinsic financial strength				aa3
Factor 3: Strength of member support (+3,+2,+1,0)			High	High
Ability to support (50%)			a2	
	Weighted average shareholder rating	a2		
Willingness to support (50%)				
	Contractual support (25%)	aaa	aaa	
	Strong enforcement mechanism	0		
	Payment enhancements	0		
	Non-contractual support (25%)		High	
Scorecard-Indicated Outcome Range				Aaa-Aa2
Rating Assigned				Aa1

Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer's performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Source: Moody's Investors Service

Related websites and information sources

» Moody's Supranational web page

» Moody's Sovereign and supranational rating list

» North American Development Bank web page

Endnotes

1 Pursuant to its charter, NADB works closely with border communities, state agencies and other entities to develop affordable and self-sustaining projects in the areas of potable water, wastewater treatment and solid waste management, as well as on projects aimed at improving air quality, conserving water, reducing energy consumption and developing renewable energy sources, combating climate change and transitioning to a greener economy, among others, located within 100 kilometers (about 62 miles) north or 300 kilometers (about 186 miles) south of the international boundary between the two countries.

2 For comparability across institutions, we include loans with interest or principal payments that are 90 days or more overdue.

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